APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 98-1649
No. 98-1741

PaineWebber Group, Inc.; PaineWebber, Inc.;
Mitchell Hutchins Asset Management, Inc.;
William J. Reik, Jr.; William D. Witter, Inc.,
Plaintiffs - Appellants,

v.

Zinsmeyer Trusts Partnership,
Defendant - Appellee.

Appeals from the United States District Court
for the Eastern District of Missouri.

Submitted: January 14, 1999
Filed: August 16, 1999

Before LOKEN, HANSEN, and MORRIS SHEPPARD ARNOLD,
Circuit Judges.

LOKEN, Circuit Judge.

Zinsmeyer Trusts Partnership ("Zinsmeyer") submitted claims of securities fraud and market manipulation to an arbitration panel of the National Association of Securities Dealers ("NASD"). After a lengthy hearing, the arbitrators dismissed all of Zinsmeyer's claims. The appellants in this court — PaineWebber Group, Inc.; PaineWebber, Inc.; Mitchell Hutchins Asset Management, Inc.; William D. Witter, Inc.; and William J. Reik, Jr.— commenced this action by filing motions to confirm the arbitration award. Zinsmeyer responded by moving to vacate the award. The district court vacated the award in favor of appellants on the ground that it was procured by undue means within the meaning of the Federal Arbitration Act, 9

U.S.C. § 10(a)(1), because PaineWebber withheld four allegedly privileged documents from discovery during the arbitration. Appellants challenge that ruling on appeal. We reverse.

I.

Zinsmeyer is a family partnership that invests the assets of various trusts. In 1986, Zinsmeyer entered into an investment advisory agreement with Mitchell Hutchins Asset Management, Inc. ("Mitchell Hutchins"), giving William J. Reik, Jr., a Mitchell Hutchins managing director, discretion to invest a portion of Zinsmeyer's total assets. Mitchell Hutchins is a subsidiary of PaineWebber, Inc., which in turn is a subsidiary of PaineWebber Group, Inc. We will refer to the three companies collectively as "PaineWebber." In February 1991, after Reik resigned from Mitchell Hutchins and took a position with William D. Witter, Inc. ("Witter"), Zinsmeyer retained Witter as investment advisor for the assets previously managed by Mitchell Hutchins. Dissatisfied with his performance, Zinsmeyer fired Reik in August 1993.

In February 1994, Zinsmeyer filed an arbitration claim with the NASD against PaineWebber, Witter, Reik, and others, alleging federal securities law violations, common law fraud, breach of fiduciary duty, breach of contract, and negligence. A panel of three arbitrators held thirty-eight sessions between March and November 1995, hearing evidence regarding Zinsmeyer's claims that Reik engaged in illegal market manipulation and other wrongdoing that caused large losses in Zinsmeyer's accounts controlled by Reik. The panel entered a final order dismissing all of Zinsmeyer's claims on November 30, 1995.

The arbitration proceedings included a major document discovery dispute over PaineWebber's claims of attorney/client and work product privilege. In 1990, a senior PaineWebber compliance officer had conducted an internal investigation of Reik's trading activities at the direction of in-house PaineWebber attorneys. In response to Zinsmeyer's document production requests in the arbitration,

PaineWebber produced thousands of documents but objected that documents generated during its internal investigation of Reik were privileged. PaineWebber provided Zinsmeyer a log describing each allegedly privileged document and identifying its unique "Bates stamp number." The 347-page privilege log contained nearly 2000 entries.

In December 1994, Zinsmeyer filed a motion challenging PaineWebber's assertions of privilege with respect to each document listed in the privilege log. The arbitrators initially ordered production of all the documents for *in camera* review, but when Zinsmeyer identified seventy that it wanted reviewed, the panel ordered those seventy produced, and they were reviewed *in camera*. After the arbitrators ruled that all but a few were privileged, PaineWebber produced those ruled not to be privileged.

In March 1995, PaineWebber produced an additional file created by the compliance officer during his internal investigation of Reik's trading activities. PaineWebber removed documents considered privileged and replaced each with a blue sheet containing the document's Bates stamp number. In May 1995, Zinsmeyer filed a motion to compel PaineWebber to produce all documents in this file that had been withheld as privileged, about seventy of which were not previously listed on the privilege log. Zinsmeyer later limited this request to twelve documents. The panel ordered those twelve produced for *in camera* review.

After the arbitration, Zinsmeyer's attorneys obtained many of the documents withheld as privileged when the district court rejected PaineWebber's claims of privilege in unrelated investor litigation. Zinsmeyer then argued that the arbitrators' award should be vacated because PaineWebber hid relevant documents through its claims of privilege. The district court agreed. Without addressing the underlying issues of privilege, the court concluded that the arbitration award was "procured by . . . undue means" within the meaning of 9 U.S.C. § 10(a)(1) because PaineWebber hid four documents from discovery by not fully or accurately describing them in its privilege log. The court further concluded that the documents were relevant to

Zinsmeyer's claims and "their absence could certainly have impacted the decision making process of the arbitrators." Finally, the court vacated the award as to Witter, as well as PaineWebber and Reik, because "the integrity of the judicial process will not permit Witter to benefit from these actions of PaineWebber." These appeals followed.

II.

Judicial review of arbitration decisions is limited. For the most part, courts may vacate an arbitration award only for the reasons set forth in the Arbitration Act. *See First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995). The statute provides that a reviewing court may vacate an award that was "procured by corruption, fraud, or undue means." 9 U.S.C. § 10(a)(1). There was no corruption or fraud in this case. The issue is whether PaineWebber procured the favorable arbitration award by "undue means" given the manner in which it claimed that certain documents were privileged from discovery in the arbitration proceedings.

A. The term "undue means" must be read in conjunction with the words "fraud" and "corruption" that precede it in the statute. *See Drayer v. Krasner*, 572 F.2d 348, 352 (2d Cir.), *cert. denied*, 436 U.S. 948 (1978). Consistent with the plain meaning of fraud and corruption, and with the limited scope of judicial review of arbitration awards, other circuits have uniformly construed the term undue means as requiring proof of intentional misconduct. *See American Postal Workers Union, AFL-CIO v. United States Postal Serv.*, 52 F.3d 359, 362 (D.C. Cir. 1995) (undue means limited to conduct "equivalent in gravity to corruption or fraud, such as a physical threat to an arbitrator"); *A.G. Edwards & Sons, Inc. v. McCollough*, 967 F.2d 1401, 1403 (9th Cir. 1992) (undue means "connotes behavior that is immoral if not illegal"), *cert. denied*, 506 U.S. 1050 (1993); *Shearson Hayden Stone, Inc. v. Liang*, 493 F. Supp. 104, 108 (N.D. Ill. 1980) ("'undue means' requires some type of bad faith in the procurement of the award"), *aff'd*, 653 F.2d 310 (7th Cir. 1981). Undue means does not include "sloppy or overzealous lawyering."

Edwards, 967 F.2d at 1403. In an unreported case, the Sixth Circuit applied this strict standard in rejecting a claim that a party used undue means to prevail in a discovery dispute before the arbitrators. *See Pontiac Trail Medical Clinic, P.C. v. PaineWebber. Inc.*, 1 F.3d 1241, 1993 WL 288301 at *5 (6th Cir. July 29, 1993). We agree with those decisions.

B. To put the issue of undue means in this case in proper perspective, we must consider the nature of a discovery dispute over allegedly privileged documents. The attorney/client privilege is based upon the principle "that sound legal advice or advocacy . . . depends upon the lawyer's being fully informed by the client." *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981). *Upjohn* involved a corporate counsel's internal investigation of possible illegal payments to foreign government officials. The Supreme Court confirmed that the privilege applies broadly to communications made by corporate employees to counsel to secure legal advice from counsel. *Id.* at 394. We have likewise applied the privilege to communications to and from corporate attorneys investigating their client's possible violations of federal securities law. *See Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 600-01 (8th Cir. 1977), followed in *In re Bieter Co.*, 16 F.3d 929, 935-36 (8th Cir. 1994). These cases confirm that PaineWebber had a reasonable basis for asserting that the attorney/client privilege, and perhaps the work product doctrine, protected from discovery in the arbitration at least some internal communications to and from the PaineWebber attorneys who conducted the investigation of Reik's trading activities.

The attorney/client privilege is waived by the voluntary disclosure of privileged communications, and courts typically apply such a waiver to all communications on the same subject matter. *See United States v. Workman*, 138 F.3d 1261, 1263 (8th Cir. 1998). Thus, a party wishing to invoke the privilege in responding to document discovery must assert it as to all documents to which it may apply. Whether a document is in fact privileged can be a difficult question, and if the parties engaging in discovery cannot resolve the issue

informally, it must be decided by the tribunal conducting the proceeding in which the privilege has been asserted. The party seeking discovery cannot see the allegedly privileged documents — that might waive the privilege — so the dispute is usually resolved by submitting them to the tribunal *in camera*. This is an awkward, time-consuming process. To make the process work, and to encourage parties to minimize the number of documents that must be reviewed *in camera*, most tribunals require the party asserting the privilege to provide the party seeking discovery with a list or log that describes the document without disclosing the allegedly privileged communications it contains. This practice is now codified in the Federal Rules of Civil Procedure, *see* Rule 26(b)(5) (1993), and it was used by the panel of arbitrators in this case.

Certain inherent aspects of this privileged document process are relevant to the "undue means" issue before us. When a party claims that certain documents are privileged and provides a list or log of those documents, the other party, the one seeking discovery, must take the initiative, for if the party seeking discovery does not press for *in camera* review of a particular document, the process ends with the claim of privilege *de facto* upheld. Because privilege disputes can only be resolved by *in camera* review of a document, formal resolution of such disputes is tedious and difficult. When many documents are at issue, the tribunal will of course want the party seeking discovery to limit the number it challenges. The tribunal ultimately decides what information must be disclosed on a privileged document log. Because that log is the basis upon which the party seeking discovery decides whether to request *in camera* review of a particular document, when the disclosure is inadequate — for example, PaineWebber's use of blue sheets to replace allegedly privileged documents in the compliance officer's file — the party seeking discovery must either demand *in camera* review of all documents, or ask the tribunal to require greater disclosure on the log. While this awkward process may seem to present the opportunity for a party to "hide" damaging documents by providing a deceptive or inaccurate privileged document log, inadequacies in

the log will become apparent to the tribunal if the party seeking discovery demands *in camera* review of some documents, and stiff sanctions may be imposed on a party whose log is found to be inaccurate or dishonest.

C. Given the importance of the attorney/client privilege and the work product doctrine, and the realities of a discovery dispute over allegedly privileged documents, we disagree with the district court's decision to vacate the arbitration award for three distinct reasons.

First, we conclude that PaineWebber did not employ "undue means" in asserting that some of its documents were privileged. In response to Zinsmeyer's discovery requests, PaineWebber individually identified each allegedly privileged document, listing the vast majority of them in its 347-page log, and showing with a blue sheet where others appeared in the compliance officer's file. This gave Zinsmeyer a basis for determining whether to request that some or all of these documents be submitted for *in camera* review of the asserted privilege.

The district court nonetheless concluded that PaineWebber's handling of four documents constituted undue means:

• The first document was a memorandum to Mitchell Hutchins's general counsel from a staff attorney recommending that restrictions be imposed on Reik's management of a closed-end mutual fund (not the Zinsmeyer account). Both this final document and an earlier draft were listed on PaineWebber's privilege log, described as documents regarding "Reik Compliance Issues." The draft was submitted for *in camera* review, and the arbitrators upheld PaineWebber's claim of privilege. Zinsmeyer did not request *in camera* review of the final memorandum. The district court concluded that PaineWebber's failure to disclose the relationship between the two documents constituted undue means.

• The second document contained handwritten notes of a meeting between the compliance officer and three Mitchell Hutchins

attorneys. PaineWebber listed this document on the log, attributing the notes to the attorneys, whose names appeared on the document. In fact, the notes were taken by the compliance officer, whose name did not appear on the document. Zinsmeyer did not request *in camera* review of this document. The court concluded this inaccuracy constituted undue means.

• The third document was a file memorandum by PaineWebber, Inc.'s general counsel describing a telephone conversation in which he told a Witter executive there was "reason to believe Reik was primarily responsible" for "millions of dollars of potential losses" to PaineWebber customers. This document was in the compliance officer's file. It was not listed on the privilege log, but a second file memorandum prepared by the same attorney on the same day regarding a conversation with the same person was listed on the log. The court concluded that not listing the document in the log was undue means.

• The fourth document was a memorandum from PaineWebber's director of compliance and Mitchell Hutchins's general counsel to PaineWebber, Inc.'s general counsel. The document was listed and correctly described on the privilege log; Zinsmeyer did not request *in camera* review. Two earlier drafts of the memorandum were produced by PaineWebber. During the arbitration hearing, while questioning the author of the drafts, counsel for Zinsmeyer asked opposing counsel whether a complete version of the draft existed. PaineWebber's counsel responded, "[t]hat is the only document that exists in the files... you have everything that exists in our client's file." The district court concluded this response was undue means.

On their face, these mistakes do not reflect the intentional misconduct that constitutes "undue means" under 9 U.S.C. § 10(a)(1). They are the kinds of errors and oversights that are apt to attend the process of claiming privilege for a large group of corporate documents. PaineWebber has offered innocent explanations for its handling of each document. It is improper to infer nefarious intent or bad faith

from what appear to be ordinary discovery errors. The district court held no evidentiary hearing, and thus there is no proof that PaineWebber's attorneys intentionally abused the process for asserting claims of privilege. Zinsmeyer was not particularly diligent or aggressive in challenging PaineWebber's claims of privilege to the arbitrators.[1] In these circumstances, the court's undue means conclusions cannot be upheld.

Second, an arbitration award may be vacated if it was "procured by" undue means. In other words, there must be some causal relation between the undue means and the arbitration award. *See Edwards*, 967 F.2d at 1403 ("the statute requires a showing that the undue means caused the award to be given"); *Forsythe Int'l, S.A. v. Gibbs Oil Co. of Texas*, 915 F.2d 1017, 1022 (5th Cir. 1990) (there must be a "nexus" between the misconduct and the arbitrator's decision); *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1383 (11th Cir. 1988) (fraud must "materially relate[] to an issue in the arbitration"); *see also BLACK'S LAW DICTIONARY* 1208 (6th ed. 1990) (to "procure" means "to cause a thing to be done"). Zinsmeyer argues that requiring the showing of a causal connection would impose an impossible burden because the arbitration panel did not state the reasons for its decision in this case. We disagree. Arbitration panels are not required to explain their decisions. *See Wilko v. Swan*, 346 U.S. 427, 436 (1953), *overruled on other grounds, Rodriguez De Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989). Thus, eliminating the need to prove a causal connection whenever an award is unexplained would effectively read the "procured by" requirement out of the statute, and would be inconsis-

[1] Three of the documents were listed on Paine Webber's privilege log, and the fourth was replaced in the compliance officer's file with a blue sheet bearing its Bates stamp number. If Zinsmeyer believed that the descriptions on the privilege log were inadequate, or that documents replaced with a blue sheet should be described, it could have asked the panel to order Paine Webber to supplement its log and pressed for a ruling on that request. *Compare Gingiss Int'l, Inc. v. Bormet*, 58 F.3d 328, 333 (7th Cir. 1995).

tent with the limited nature of judicial review of arbitration awards. *See Edwards*, 967 F.2d at 1403.

Zinsmeyer further argues that there is proof of the requisite causal connection because PaineWebber hid relevant evidence by undue means, namely, the manner in which PaineWebber disclosed the existence of four *allegedly* privileged documents. Assuming for the sake of argument that PaineWebber's errors constituted undue means, we will further assume that, absent those errors, Zinsmeyer would have included the four documents in the group submitted to the arbitration panel for *in camera* review. But the documents would not have been produced, and therefore would not have been available as evidence, unless the arbitrators overruled PaineWebber's claims of privilege. Thus, a fatal flaw in Zinsmeyer's argument, and the district court's decision, is the complete failure to address the merits of the privilege issues. The arbitrators upheld PaineWebber's claims of privilege on most documents submitted for *in camera* review, and Zinsmeyer has not challenged those rulings. On this record, to give the arbitration award the deference it is due, we must assume that claims of privilege not submitted to the panel for *in camera* review would also have been upheld. Therefore, Zinsmeyer has failed to prove that PaineWebber's errors in the privileged document process, even if intentional and therefore a form of undue means, "procured" the arbitration award.

Third, a related but distinct flaw in Zinsmeyer's argument is its failure to explain how PaineWebber's alleged undue means affected the arbitration hearing record. Assuming now that the arbitrators would have overruled PaineWebber's claims of privilege had the four documents been submitted for *in camera* review, that does not mean that new material evidence would have found its way into the hearing record. "The privilege only protects disclosure of communications; it does not protect disclosure of the underlying facts by those who communicated with the attorney." *Upjohn*, 449 U.S. at 395. The documents appear to add little to the evidence presented during the thirty-eight-day hearing regarding Reik's trading activities and PaineWebber's investigation of those activities.

For example, one of the four documents consisted of notes by a PaineWebber attorney of his phone conversation with a Witter executive. Zinsmeyer argues that it would have called the Witter executive as an adverse witness if the document had been produced. But the phone conversation, which involved employees of two independent investment firms, was not privileged (though the attorney's file notes might have been properly listed as privileged if they included work product). PaineWebber disclosed the *fact* of the conversation on its privilege log. Thus, it was not PaineWebber's alleged undue means that kept the substance of the conversation out of evidence, it was Zinsmeyer's lack of interest in obtaining and presenting that evidence.

Zinsmeyer's brief effectively demonstrates that its attorneys in the arbitration would have found the four documents very interesting. But Zinsmeyer fails to show how production of those four documents would have resulted in additional *facts* being presented to the arbitration panel. For this reason, too, Zinsmeyer failed to prove that the alleged undue means procured the arbitrators' award.

For each of the foregoing reasons, the district court erred in vacating the arbitration award in favor of the PaineWebber companies, Witter, and Reik on the ground that the award was procured by undue means.

III.

Zinsmeyer argues that even if the arbitration award was not procured by undue means, it must be vacated because of the arbitrators' "bias and misconduct." Zinsmeyer points to comments by the arbitrators that the hearing was taking too long, that it was interfering with their practices, and that they were relatively underpaid for this work. Zinsmeyer argues that this attitude caused the arbitrators to deny Zinsmeyer's motions for continuances to pursue discovery issues, thereby playing into PaineWebber's strategy to stonewall discovery and to rush the proceedings to judgment before its bad documents came to light. Zinsmeyer does not challenge

the merits of the arbitrators' procedural rulings. Rather, it argues the award should be vacated because of "evident partiality or corruption in the arbitrators." 9 U.S.C. § 10(a)(2). Zinsmeyer waived this contention by failing to raise it to the arbitrators. *See Kiernan v. Piper Jaffray Companies, Inc.*, 137 F.3d 588, 593 (8th Cir. 1998); *Fort Hill Builders, Inc. v. Nat'l Grange Mut. Ins. Co.*, 866 F.2d 11, 13 (1st Cir. 1989).

In addition, when viewed in the light of our limited power to review arbitration awards, the argument borders on the frivolous. Challenges to arbitration awards based on partiality generally involve claims that the arbitrators failed to disclose relationships that "create an impression of possible bias." *Olson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 51 F.3d 157, 159 (8th Cir. 1995), *citing Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 149 (1968). Here, no such relationship is alleged, and there is no evidence the arbitrators had any financial or personal interest in the outcome of the arbitration. Moreover, nothing in the arbitrators' comments evidences partiality to one side or the other. Read in context, the comments reflect an understandable desire to move the arbitration along, which, far from demonstrating bias, is consistent with the general policies underlying arbitration. *See Ballantine Books, Inc. v. Capital Distrib. Co.*, 302 F.2d 17, 21 (2d Cir. 1962) ("an arbitrator should . . . expedite the proceedings . . . since among the virtues of arbitration . . . are speed and informality").

The judgment of the district court is reversed and the case is remanded with directions to grant appellants' motions to confirm the award.

A true copy.

Attest:

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EIGHTH CIRCUIT.

APPENDIX B

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

No. 4: 95CV02528 ERW

ZINSMEYER TRUSTS PARTNERSHIP, a Missouri General Partnership, by Andrew Roberts Zinsmeyer Trust dated July 27, 1964, Jeffrey Woods Zinsmeyer Trust dated July Trust B dated November 29, 1971, Andrew R. Zinsmeyer Revocable Trust date August 27, 1982, Mary Jane Zinsmeyer Trust dated August 27, 1964, Andrea Zinsmeyer Trust B dated April 15, 1983, Daniel M. Zinsmeyer Trust B dated February 5, 1985, Amy S. Zinsmeyer Trust dated January 19, 1987, Jonathan Roberts Zinsmeyer Trust B dated February 10, 1989, Daris Zinsmeyer Education Trust dated December 22, 1982,
and Jada Partnership, General Partners,
Plaintiff/counter-claim defendant,

v.

MORGAN STANLEY & CO., INCORPORATED;
KIDDER PEABODY & CO., INCORPORATED,
Defendants/counter-claimants.

Consolidated with: No. 4: 95MC00318 ERW

PAINEWEBBER GROUP INC.; PAINEWEBBER, INC.;
MITCHELL HUTCHINS ASSET MANAGEMENT INC.;
WILLIAM J. REIK, JR.; WILLIAM D. WITTER, INC.;
Plaintiffs,

v.

ZINSMEYER TRUSTS PARTNERSHIP,
Defendant.

[Filed April 15, 1997]

MEMORANDUM AND ORDER

This matter is before the Court on the application of plaintiff Zinsmeyer Trusts to vacate an arbitration award [document #1 in Case No. 4:95CV02528 ERW], on the counterclaim of defendant Morgan Stanley for an order and judgment confirming an arbitration award [document #10 in Case No. 4:95CV02528 ERW], on the counterclaim of defendant Kidder Peabody & Co. for an order and judgment confirming an arbitration award [document #12 in Case No. 4:95CV02528 ERW], on the motion of plaintiffs PaineWebber Group Inc., PaineWebber Incorporated, Mitchell Hutchins Asset Management Inc., William Reik, Jr. and William D. Witter, Inc. (hereinafter referred to collectively as "PaineWebber" or "the PaineWebber respondents") for judgment confirming and arbitration award [document #1 in Case No. 4:95MC00318 ERW], on the cross-motion of defendant Zinsmeyer Trust Partnership to vacate an arbitration award [document #4 in Case No. 4:95MC00318 ERW], on the motion of PaineWebber for leave to file a response to Zinsmeyer's supplemental memorandum in support of its motion to vacate [document #53 in Case No. 4:95CV02528 ERW], and on the motion of Zinsmeyer Trust Partnership for a hearing on the motions to vacate an the arbitration award [document #63].

I. Background

Zinsmeyer is a family partnership of various individual trusts established to preserve capital and generate income for the beneficiaries. In early 1986, Andrew Zinsmeyer, who controlled the partnership assets, retained Bill Reik and signed a discretionary investment advisory agreement, giving sole discretion to Mitchell Hutchins to manage the investments. Reik was then a managing director at Mitchell Hutchins, an investment advisory firm that is a subsidiary of PaineWebber. PaineWebber Group is a holding company that oversees both PaineWebber and Mitchell Hutchins.

Zinsmeyer began to experience trouble with Reik's advisory investing in late 1989 and 1990, when Reik requested $600,000 in

additional capital to "weather" a downturn in the market, when Zinsmeyer loaned certain Novellus stock to Reik to attempt to recoup Zinsmeyer's investment, and when Zinsmeyer received several margin calls on its account with Mitchell Hutchins. On February 8, 1991, Reik was apparently involuntarily terminated from Mitchell Hutchins and PaineWebber. Andrew Zinsmeyer testified at the arbitration that he was never informed of the circumstances surrounding Reik's departure from Mitchell Hutchins and PaineWebber.

Reik immediately joined the investment firm of William Witter. In connection with this move, Zinsmeyer entered into a discretionary investment advisory agreement with William Witter, giving William Witter sole discretion to manage its investments. At this same time, Reik directed Zinsmeyer to open a margin account at Morgan Stanley, a brokerage house, and custody of the Zinsmeyer assets managed by Reik at PaineWebber was transferred to Morgan Stanley. Andrew Zinsmeyer testified that Reik had initially indicated to him that his account was appreciating in value, but that Reik later informed him of "margin problems" with the Morgan Stanley account. Zinsmeyer testified that he never received notice of any margin calls from Morgan Stanley, although he later learned that there had been numerous such margin calls.

Around June 1991, Reik transferred the Zinsmeyer account to Kidder Peabody brokerage house. Zinsmeyer received a margin call while his account was at Kidder Peabody. Zinsmeyer continued to have problems with Reik and Reik's management of the account. Ultimately, Zinsmeyer terminated its business with Reik in August, 1993.

An arbitration claim was initiated in February, 1994 by Zinsmeyer Trust Partnership (hereinafter Zinsmeyer) with the National Association of Securities Dealers (NASD) against PaineWebber Group Inc., PaineWebber Inc., Mitchell Hutchins Asset Management Inc., Morgan Stanley, Kidder Peabody, William D. Witter, Inc., William J. Reik, Jr. (Bill Reik), and Trey

Reik. The claim arose out of Zinsmeyer's investment relationship with these respondents. In a lengthy statement of claim, Zinsmeyer set forth the alleged events and actions of Bill Reik, and his son, Trey Reik. In Count I, Zinsmeyer claimed that Bill Reik, Mitchell Hutchins, PaineWebber and William Witter engaged in a complex scheme to manipulate the stock prices for and market in Neutrogena, Tejon Ranch, and Frisch's Restaurants; that Reik and these respondents omitted or failed to state numerous material facts to Zinsmeyer regarding Reik's investment activities and his alleged scheme to manipulate prices; and that such omissions and activities of respondents operated as a fraud upon Zinsmeyer in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. In Count II, Zinsmeyer alleged that Reik, Mitchell Hutchins, PaineWebber and William Witter engaged in unlawful manipulation of the security prices for Tejon Ranch and Frisch's Restaurants in violation of Section 9(a)(2) of the Securities Exchange Act of 1934, 15 U.S.C. § 78i(a)(2). In Count III, Zinsmeyer alleged that Reik, Mitchell Hutchins, and William Witter engaged in a scheme to manipulate the prices for and markets in the stocks of Neutrogena, Tejon Ranch, and Frisch's Restaurants and omitted to state material facts in furtherance of the scheme, with the intent of deceiving Zinsmeyer or with reckless disregard for the welfare of Zinsmeyer, and that such conduct operated as a fraud upon Zinsmeyer in violation of Section 206 of the investment Advisors Act of 1940, 15 U.S.C. § 80b-6. Count IV alleged common law fraud against the PaineWebber respondents; Count V alleged breach of fiduciary duty by the PaineWebber respondents; Count VI alleged breach of contract claim against the PaineWebber respondents, Morgan Stanley, and Kidder Peabody; and Count VII alleged a negligence claim against the PaineWebber respondents, Morgan Stanley, Kidder Peabody and Trey Reik.

The arbitration consisted of a total of 38 hearing sessions between the dates of March 27, 1995, and November 2, 1995. Each session lasted approximately four hours. On September 11, 1995, the arbitrators dismissed Zinsmeyer's claims against Kidder Peabody

and Morgan Stanley. On November 2, 1995, the remaining respondents moved for dismissal of Zinsmeyer's claims. On or about November 13, 1995, after hearing oral arguments and requesting briefing on the motions, the arbitrators determined that the motion to dismiss should be granted. On or about November 30, 1995, the NASD issued its final order in the arbitration.

Zinsmeyer then brought an action to vacate the arbitration award as to Morgan Stanley and Kidder Peabody; Morgan Stanley and Kidder Peabody counterclaimed, seeking confirmation of the arbitration award. *See* Case No. 4:95CV02528 ERW. PaineWebber Group Inc., PaineWebber Incorporated, Mitchell Hutchins, Bill Reik and William Witter commenced a different action to have the arbitration award confirmed; Zinsmeyer counterclaimed to have the arbitration award vacated. *See* Case No. 4:95MC00318 ERW.

On March 11, 1996, the Court consolidated these actions. The Court determined that the motions to vacate were timely brought within three months of the arbitration award. *See* 9 U.S.C. § 12. The Court, after reviewing the initial motions of all parties, then set a briefing schedule under which the parties could submit memorandum in support of their motions. Subsequent to this briefing, the Court also granted Zinsmeyer leave to file several supplemental memoranda in support of its motion to vacate, requesting briefing on issues raised in these supplemental memoranda as well. The issues have now been fully briefed and the Court will now consider all issues raised in the motions.[1]

II. Zinsmeyer's Motion to Vacate

Zinsmeyer seeks to vacate the arbitration award. All parties agree that the Federal Arbitration Act (FAA), 9 U.S.C. § 1 *et seq.*,

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[1] Zinsmeyer has moved for a hearing on the motions to vacate the arbitration decision. The Court has permitted considerable opportunity for briefing all issues in the motions and the Court, in its discretion, will deny Zinsmeyer's request for oral argument on the motions. *See* Eastern District of Missouri Local Rule 4.02(A).

governs these proceedings. Under the FAA, a federal court may reverse an arbitration award only under limited circumstances. Section 10) (a) of the FAA permits a federal court to vacate an arbitration award (1) where the award was procured by corruption, fraud, or undue means, (2) where there exists evident partiality or corruption in any of the arbitrators, (3) where the arbitrators engaged in misconduct in refusing to postpone the arbitration hearing or in refusing to consider relevant evidence, or engaged in any other prejudicial misbehavior, or (4) where the arbitrators exceeded their powers by making an award not within their powers. 9 U.S.C. § 10(a); *DVC-JPW Investors v. Gershman*, 5 F.3d 1172, 1174 (8th Cir. 1993). The burden of proof rests squarely on Zinsmeyer, as it is the party attempting to vacate the arbitration award. *M & A Electric Power Coop. v. Local Union No. 702 Internat'l Bhd. Of Elec. Workers, AFL-CIO*, 773 F. Supp. 1259, 1262 (E.D. Mo. 1991).

As grounds for its motion, Zinsmeyer asserted that the arbitrators (1) improperly denied Zinsmeyer's request for postponement of the arbitration hearing, (2) were biased and partial, and engaged in misconduct, (3) refused to allow evidence which was pertinent and material to the controversy, and (4) made a decision in manifest disregard of the law. Zinsmeyer subsequently asserted an additional ground — that PaineWebber obtained the arbitration award by undue means by improperly withholding material and important documents and denying Zinsmeyer discovery of such documents, and thus, precluding their review and consideration by the arbitrators.

Relevant to Zinsmeyer's arguments that the arbitration order should be vacated due to the arbitrators' refusal to postpone the hearing, the arbitrators' refusal to hear material evidence, and the arbitrators' bias, partiality and misconduct, which all fall under the sections 10(a)(2) and (3) of the FAA, the relevant record, as presented by the parties, reveals the following. Zinsmeyer first filed its statement of claim in February, 1994. On May 23, 1994, Zinsmeyer's counsel, Thomas E. Douglass, sent a letter to the NASD Arbitration Department, stating that it was Zinsmeyer's

judgment that the matter would not be ready for arbitration until the first quarter of 1995. The letter also indicated concern over whether Kidder Peabody would submit to arbitration, in light of Kidder Peabody's challenge in federal court as to whether it was required to submit to arbitration.

On September 15, 1994, NASD sent Zinsmeyer a letter and an "advance sheet" for the arbitration hearing, which included the identity of the three arbitrators selected for the hearing. The letter provided information for the upcoming arbitration, including instructions as to postponement of the hearings. The letter indicated that any questions concerning subpoenas or orders of production should be directed to Mark Nowicki *immediately*; that postponement requests would decided by the arbitrators; and that any party seeking to disqualify one of the three selected arbitrators should contact Nowicki immediately. In an October 7, 1994 letter the NASD notified Zinsmeyer, in light of Zinsmeyer's objections to two of the initially selected arbitrators, of the identity of the two new replacement arbitrators, one of whom was Sherrie L. Catlett. On October 28, Zinsmeyer wrote to the NASD, pursuant to Section 21 of the NASD Arbitration Code of Procedure, requesting further information regarding Catlett's background. NASD apparently informed Catlett of Zinsmeyer's inquiry and Catlett provided a detailed response to this inquiry in early November, 1994, in her effort to clarify "any concerns the claimant may have about [her] background."

Zinsmeyer served upon PaineWebber its first request for production of documents on August 12, 1994, requesting, among other items, all documents regarding Bill Reik's trading activity in Frisch's Restaurants, Tejon Ranch, and Neutrogena. PaineWebber had initially refused to produce any documents unless they were subject to a confidentiality agreement similar to a protective order in a related action, *Bond v. PaineWebber Group, Inc., et al.*, Case No. 2:93CV00071. Around December 15, 1994, PaineWebber apparently changed its position and produced "all responsive documents relating to [Zinsmeyer's] account that were not previously produced to plaintiff's counsel pursuant to the *Bond* case." PaineWebber,

however, continued its objections to the discovery of documents relating to Bill Reik and customer accounts controlled by Reik, unless a confidentiality agreement could be reached. On December 23, Zinsmeyer filed a motion to compel discovery from the PaineWebber respondents. In late December, Zinsmeyer also moved to adjourn the January 23, 1995 hearing date, citing discovery disputes, including the disagreement over a confidentiality agreement, and Kidder Peabody's refusal to submit to the arbitration.

On January 6, 1995, after losing its challenge in federal court regarding its submission to the arbitration, Kidder Peabody filed an answer to Zinsmeyer's arbitration claim. On January 18, 1995, the arbitrators issued several orders: they granted Zinsmeyer's motion to adjourn - in that they granted a two day continuance of the arbitration hearing; they entered an interim order of confidentiality regarding the PaineWebber discovery; they ordered, as to all documents for which a privilege was asserted, in camera production and a copy of the privilege log for all such documents; they ordered all discovery to be completed by January 20; and they advised that they would rule on the discovery of the documents for which a privilege was asserted on January 25, the first day of hearings.

On January 20, Zinsmeyer moved for reconsideration of the two-day continuance of the hearings, citing its difficulty in obtaining discovery from respondents, the complexity of the alleged trading scheme of Reik and the respondents, the need for more time for Zinsmeyer to review recently obtained discovery, and the late entry of Kidder Peabody into the arbitration. In a letter dated January 20, Zinsmeyer was advised that the arbitration panel had granted the motion for reconsideration. The letter also advised that all discovery was to be completed by February 27 and that the hearings would begin on March 27 through March 31, with additional hearing dates, if necessary, to be set at that time. On January 24, Zinsmeyer moved to shorten the time for Kidder Peabody, who only submitted to arbitration in January, 1995, to respond to Zinsmeyer's recently propounded discovery requests, citing the need to complete such

discovery before the March 27 deadline and for time to prepare its case. This motion was denied.

On March 6, PaineWebber indicated that it objected to requiring William Cavell, a compliance officer at Mitchell Hutchins and a supervisor of Bill Reik, to testify at the arbitration; PaineWebber also objected to Paul Guenther, one of the presidents at PaineWebber, being required to appear, asserting that he had a tremendously busy schedule. In a letter dated March 16, 1995, Zinsmeyer requested that the arbitration panel reconsider "its denial of Zinsmeyer's motion for postponement." As grounds for reconsideration, Zinsmeyer asserted that its counsel would be busy with discovery, pre-trial and trial in the federal case of *Houston Municipal Employees Pension System v. PaineWebber Group Inc. et al.*, a case that was also based upon Bill Reik's trading practices and activities, and thus would not be available for additional hearings during the months of April through July, causing disruptions in the presentation of the case; that PaineWebber had objections pending to the appearances of Cavell and Guenther, two witnesses that Zinsmeyer planned to call at the March 27-31 hearings; that Zinsmeyer was expecting to soon receive approximately 11,000 documents from respondents and needed additional time to review them; and that Zinsmeyer was having difficulty obtaining evidence through several third-party subpoenas. Zinsmeyer also requested reconsideration of the arbitrators' "ruling relating to the hearing testimony of William Cavell." As grounds for this motion, Zinsmeyer asserted that Cavell was a crucial witness, as Cavell was directly responsible for supervising Reik; and that Zinsmeyer needed to question Cavell regarding hundreds of documents, and would be prejudiced in its ability to effectively question Cavell if limited to one day of testimony from Cavell, as was previously granted by the arbitrators. On March 20, the arbitrators held a pre-hearing conference. After oral arguments at the conference, during which Zinsmeyer told the arbitrators that Zinsmeyer had only just received 11,000 documents from PaineWebber which Zinsmeyer needed additional time to review and to show its experts, the arbitrators denied Zinsmeyer's efforts to

postpone the hearing, ordered the hearing to commence on March 27, ordered Cavell to appear for two days, March 28 and 29, and ordered Paul Guenther to appear at a hearing session at a later determined date.

The hearings began on March 27, 1995. At one instance on March 29, Cavell, under examination, could not identify a document presented to him by Zinsmeyer, even though that document was produced by PaineWebber. On that same day, Kidder Peabody complained that they should be dismissed, as no evidence regarding them had yet been presented at the hearing. On March 28, at the close of a hearing session and while the parties were discussing scheduling matters, Arbitrator Thomas Cipolla, chairperson of the arbitration panel, indicated to Zinsmeyer that, if its next witness, Richard Engelhardt failed to appear, the panel would be prepared and expect to hear testimony of another witness. In this context, Cipolla stated, "[w]e can take these out of order . . . we're somewhat, maybe naively, a little bit more sophisticated than a normal jury in St. Louis." Cipolla also, in discussing with the parties his concern for keeping the arbitration moving, stated,

> I think that what you all have got to realize is that we, we all work . . . I know this is your job and maybe your career, but — and it may be our career as arbitrators.

In response to Cipolla's comment, arbitrator Charles Seigel quipped, "I'll be out of business in a few days" and Catlett added, "Me, too."

On March 29, the arbitrators further discussed scheduling and witness matters, as the parties were in apparent continued disagreement as to when and how long certain PaineWebber and Mitchell Hutchins supervisors were to appear. Cipolla encouraged the parties to work out the differences among themselves, stating, "[i]t should not be incumbent upon the Panel and the NASD to be ordering the witnesses, putting the witnesses in the order that you want and all the other stuff." Cipolla then added that if the parties could not agree, he would be prepared to make certain orders as required. Cipolla also stated,

> I don't mind saying that I don't get paid very much for being here. I was originally told this case was going to take a week. I now see that this case is probably going to take several months, and I'm in a small law firm, two lawyers with us. Every day I'm out of that office . . . I don't mind saying, this is going a lot slower and it's going to be a lot longer than it was represented to us originally . . . and it's a tremendous burden for what they pay us here, which is virtually nothing, for me to leave my practice, and so I'm asking everyone to take that in consideration, and we're all — we all have jobs, so please try to work this thing out so that everything goes more smoothly, when we come back, we can get to the substantive evidence that needs to be presented and move on . . . I ask that as a professional courtesy to all you.

The hearing was adjourned and the arbitration was to be reconvened on April 10, with Richard Engelhardt, a compliance officer for PaineWebber who investigated Reik's activities, required to be in attendance. The arbitrators also ordered interim forum fees to be assessed against Zinsmeyer for the days of March 30 and 31, for failing to have more witnesses ready to testify at that time.

The hearings reconvened on April 10. At one point in the hearing session on April 10, arbitrator Seigel interrupted a discussion to raise a point. After stating his opinion, Seigel added, "and I hope I'm not speaking out of turn Mr. Chairman." In response, Cipolla stated, with apparent reference to the extra rate at which the panel chairperson was compensated, "I'll split the fifty bucks extra, I guess, for being Chair with you." Seigel then added, in apparent reference to the low compensation of the arbitrators, "Given the fact that that's about two-thirds of what I get all day anyway." The transcript indicates that these responses evoked laughter among some of those present.

Also on April 10, counsel for Zinsmeyer and counsel for Morgan Stanley entered into a written stipulation that Zinsmeyer would advise Morgan Stanley five days of any hearing as to whether any evidence to be presented would relate to Morgan Stanley. Because Zinsmeyer's

evidence often related solely to other respondents, the stipulation also provided that Morgan Stanley's presence was not required at some hearings.

On April 11, Cavell, under examination, stated that he could not identify another document, which apparently was a copy of a February 24, 1988 facsimile to PaineWebber from Stifel Nicolaus regarding a letter from Andrew Zinsmeyer to Robert Wood at Stifel Nicolaus. The arbitrators refused to consider the document as Cavell could not recognize it.

The hearings reconvened on April 10. On April 11, the arbitrators gave Zinsmeyer the option of either producing Guenther as a live witness for one day, or for providing Guenther's video deposition. The arbitrators stated that should Zinsmeyer not have any witness ready to testify on April 12, they would be willing to consider sanctions against Zinsmeyer, including dismissal. Zinsmeyer apparently chose to use Guenther's deposition testimony instead of live testimony.

On May 15 and 16, the arbitrators shifted the arbitration to New York, to obtain the testimony of Richard Engelhardt, a former compliance officer at PaineWebber who investigated Reik and allegedly found numerous transgressions by Reik. Engelhardt apparently refused to travel to St. Louis. Engelhardt left PaineWebber in 1993, due to his wife's poor health. During direct examination of Engelhardt by Zinsmeyer's counsel on May 15, Engelhardt expressed objection to the behavior of two attorneys for the PaineWebber respondents. Upon objection, the following occurred:

> ARBITRATOR CIPOLLA: Okay, Mr. Engelhardt, I am going to instruct you, we do not need to have your comments directed at the lawyers.
>
> ENGELHARDT: You have got to see the facial expressions going on here. The interplay between these two people.
>
> ARBITRATOR CIPOLLA: Don't worry about it.

ARBITRATOR SEIGEL: You just testify. They can do whatever they want. Your testimony shouldn't change one way or the other depending on their facial expressions.

ENGELHARDT: Why don't you instruct them to —

ARBITRATOR SEIGEL: If we feel there is any inappropriate behavior the chairperson will take care of it. Let the chairperson handle that. You testify to facts that you know, period.

ENGELHARDT: It's being made more difficult by these frequent exchanges and facial expressions.

MR. DOUGLASS (Zinsmeyer's counsel): All right, let's don't get into that.

At the hearing session on May 15, the arbitrators also ruled that Zinsmeyer could not present several witnesses who were also clients of Bill Reik. Zinsmeyer wanted to present these witnesses, asserting that they would testify that Reik refused to follow their trading instructions, just as Andrew Zinsmeyer had testified that Reik had failed or refused to follow Zinsmeyer's instructions. Zinsmeyer's counsel asserted that such testimony was important to proving intent and a pattern of fraud through non-disclosure on the part of Reik. Arbitrator Cipolla, explained that he understood Zinsmeyer's argument, however, he was not going to allow the evidence as he believed it was irrelevant to the critical issues in the action, including the relationship of Reik with Andrew Zinsmeyer. Cipolla stated that it was his feeling that he did not see the "necessity" of bringing several witnesses to testify as to the underlying transactions which Zinsmeyer alleged were part of the pattern and practice of Reik, and that he did not want to get into collateral issues regarding the veracity of these witnesses testimony regarding Reik's alleged refusal to follow client instructions, but that he would "allow [Zinsmeyer] to use documents that show trading in other accounts and from that [Zinsmeyer could] argue [its] case accordingly."

On the next day, May 16, during cross-examination of Engelhardt by the PaineWebber respondents' counsel, Engelhardt, after testifying that Reik was placing orders to manipulate the stock of Neutrogena, insisted that he be allowed to address the panel of arbitrators. The transcript reveals that the following took place:

> ENGELHARDT: Please, the Panel it's interesting to me that PaineWebber —
>
> ARBITRATOR CIPOLLA: There is not a question for you.
>
> MR. HIGGINS (counsel for respondents): There is not a question for you.
>
> ENGELHARDT: Thank you very much.
>
> MR. DOUGLASS (counsel for Zinsmeyer): Just answer the question.
>
> Q.: Let me direct your attention to Bates stamp page 304205.
>
> ENGELHARDT: Excuse me a second.
>
> MR. HIGGINS: There is no pending question.
>
> ARBITRATOR SEIGEL: I know, but, Mr. Douglass, you are not his counsel.
>
> MR HIGGINS: I know.
>
> ARBITRATOR SEIGEL: If you talk right now, I have to tell you something, I am going to ask you exactly what happened.
>
> MR. HIGGINS: Okay.
>
> ENGELHARDT: I would like to address the panel.
>
> MR. HIGGINS: Why don't you just answer the questions.
>
> ENGELHARDT: I would like to address the panel for two minutes.

ARBITRATOR CIPOLLA: You can at the end of the day.

ENGELHARDT: The end of the day is five o'clock, as you said yesterday.

ARBITRATOR CIPOLLA: It may well be longer than that if we don't move this along.

ENGELHARDT: No, it won't.

ARBITRATOR CIPOLLA: Yes, it will, Mr. Engelhardt. I can guarantee you that.

ENGELHARDT: You can guarantee me?

ARBITRATOR CIPOLLA: I guarantee it. You will be here tomorrow, too, sir.

ENGELHARDT: So will you.

ARBITRATOR CIPOLLA: You are damn right I will be.

ARBITRATOR SEIGEL: We have to be here anyway.

ARBITRATOR CIPOLLA: Mr. Engelhardt, I am probably the most patient man that's sitting in this room and you have got me upset. Now, if you just answer the questions. You are your own worst enemy by not answering the questions. If you answer the questions you will be out of here by five o'clock.

ENGELHARDT: Why can't you listen to me for two minutes?

MR. HIGGINS: Answer the question.

ARBITRATOR CIPOLLA: Answer the questions, Mr. Engelhardt.

ENGELHARDT: Thank you for your lack of cooperation.

ARBITRATOR CIPOLLA: Thank you for your lack of cooperation.

ENGELHARDT: And thank you very much for coming here. I appreciate your concern, if I didn't tell you that before.

ARBITRATOR CIPOLLA: That's it. We are taking a five-minute break. My father is in the hospital, I could give a damn. I was sympathetic to your position.

ENGELHARDT: You were? Why did you make it so difficult?

(Recess taken.)

ARBITRATOR CIPOLLA: First thing, I just want to get this over with, I need to apologize to everybody here. I have conducted about 150 arbitrations. I have had lawyers blow up, I have had witnesses blow up, I have had everything. I guess it was time for the arbitrator to blow up. It's unprofessional behavior, I apologize for it. I apologize to everybody here and Mr. Engelhardt and what we are going to do is for the remainder of this witness' testimony, Mr. Seigel is going to handle the chair's role. I will give him his extra $25 for this session.

ARBITRATOR SEIGEL: And for the record, I am going to take it. In light of the fact that doubles the amount I get for a per diem amount.

ARBITRATOR CIPOLLA: That puts you up to 250. Other than that, I am sincerely sorry for the outburst and presumably it has only happened one out of 150 times so we are several years away from another one. Anyway, where do we stand in terms of—

MR. DOUGLASS: Thank you, Mr. Chairman, I apologize if there has been anything from this end. People are under a lot of stress, both Mr. Engelhardt and I understand you and we appreciate that.

Examination of Engelhardt was completed shortly thereafter and the session was adjourned for the day.

In a June 26, 1995 letter to PaineWebber's counsel, Zinsmeyer informed PaineWebber that Zinsmeyer had not received certain documents which were requested in Zinsmeyer's August 12, 1994 discovery request. Zinsmeyer stated that these documents included "PaineWebber Trading Activity Reports" and "Blue Sheet Reports" for Frisch's Restaurants, Neutrogena, Tejon Ranch, and the Cypress Fund for the period of January, 1989, through December, 1990. On September 25, PaineWebber apparently provided the missing "PaineWebber Trading Activity Reports," to counsel for Zinsmeyer, as PaineWebber produced these documents in regard to the *City of Houston Municipal Employees Pension System v. PaineWebber Group Inc., et al.*, litigation. PaineWebber had apparently provided only trading activity reports for the period of 1986 to 1988 in late-February, 1995.

On June 30, 1995, Cipolla, corrected the parties' incorrect assumption that no depositions could be taken of anybody at Kidder Peabody or Morgan Stanley. While Cipolla stated that "[w]e are not going to meet as a Panel to help in the discovery of [the] case for [Zinsmeyer], Cipolla expressly permitted Zinsmeyer to take depositions of witnesses at Kidder Peabody and Morgan Stanley over the following two to three weeks. Cipolla stated that he wanted to see the deposition testimony, and would determine if live testimony regarding Kidder Peabody and Morgan Stanley was necessary after reviewing the depositions. Cipolla added that they would entertain any motions regarding those two respondents after that time.

On July 13, Zinsmeyer deposed Bernard Stern, the principal account representative in charge of Zinsmeyer's account at Morgan Stanley. On July 14, Zinsmeyer apparently took the deposition of Matthew Gorman, the Kidder Peabody broker who handled Zinsmeyer's account. On August 10, Morgan Stanley filed another motion to dismiss. On August 21, Kidder Peabody filed a renewed motion to dismiss, based in part on Gorman's deposition, asserting that Kidder Peabody was merely the executing broker for Reik and Zinsmeyer and that Kidder Peabody had no reason to know that Reik was not following Zinsmeyer's

investment instructions. On September 11, after briefing by the parties, the arbitrators dismissed the claims against Kidder Peabody and Morgan Stanley, thus, granting their motions to dismiss.

At the November 1 hearing session, Zinsmeyer sought to introduce the expert opinions of Raymond Kalinowski, a former Chief Operation Officer of A.G. Edwards. The arbitrators ruled that Kalinowski could not testify or give his opinions as to statements, representations, or omissions made by Reik to customers other than Zinsmeyer. In limiting Kalinowski's testimony, the arbitrators stated that they wanted to stay focused on any misrepresentations made by Reik to Zinsmeyer; that they thought that Kalinowski was going to give expert testimony regarding damages. The arbitrators suggested that they already accepted the fact that Reik's trading program was one that could lend itself to manipulative activities. The arbitrators did elicit from Kalinowski his opinion that Andrew Zinsmeyer fell within the definition of a sophisticated investor. At the end of the day, Cipolla, stressing the arbitrators' desire to hear evidence on damages and causation, limited Kalinowski to two more hours of testimony on the next day.

A. Refusal to Postpone the Arbitration Hearing

Zinsmeyer argues that the arbitrators unreasonably forced the arbitration hearing to commence before discovery was complete and before Zinsmeyer could review voluminous discovery received on the eve of the first hearing session. A refusal to postpone arbitration hearings, when there is sufficient cause shown to do so, is a type of misconduct provided for under 9 U.S.C. § 10(a)(3). *Lee v. Chica*, 983 F.2d 883, 888 n.8 (8th Cir.), *cert. denied*, 510 U.S. 906 (1993). Arbitrators have discretion as to whether to grant a motion to postpone an arbitration hearing. With respect to vacating arbitration orders due to failure to postpone hearings, the Eighth Circuit has stated that "[i]f any reasonable basis exists for the arbitrators' decision not to postpone a hearing, [the court] will

not intervene." *DVC-JPW Investors*, 5 F.3d at 1174; *see also ARW Exploration Corp. v. Aguirre,* 45 F.3d 1455, 1463-64 (10th Cir. 1995). Even if no reasonable basis exists for such decision, the party seeking to vacate must also show that the error on the part of the arbitrators so affected the rights of the party that it may be said that the party was deprived a fair hearing. *Grahams Serv. Inc. v. Teamsters Local 975*, 700 F.2d 420, 422-23 (8th Cir. 1982).

Had the arbitrators refused to grant Zinsmeyer the continuance of the hearings from January to March 27, the Court would have little difficulty deciding that the arbitration award should be vacated. However, the arbitrators granted a two month continuance, which was necessary in light of the late entry of Kidder Peabody into the arbitration, and the need to complete considerable discovery and resolve outstanding discovery disputes, which arose, in part, because of PaineWebber's zealous opposition to the discovery of many documents, and in part because of Zinsmeyer's delay until August, 1994, to serve discovery requests upon PaineWebber.

The arbitrators' decision to stand firm with its refusal to grant yet another continuance is questionable in light of the fact that PaineWebber only produced considerable documentary evidence approximately ten days before the March 27 hearings, even though the arbitrators earlier ruled that discovery should be completed at an earlier time. Zinsmeyer's argument that it was unable to properly digest the discovery and prepare its case prior to the March 27 hearing raises concern to the Court that the Zinsmeyer's presentation and examination of key witnesses at the March and April hearings could have been negatively impacted.

However, the Court cannot conclude that no reasonable basis existed for the arbitrators to not grant another continuance. Zinsmeyer initially indicated to NASD that the matter would be ready for arbitration hearings in the first part of 1994, and the arbitrators had already granted a two-month continuance. The arbitrators did not need to grant Zinsmeyer yet another continuance, based upon these circumstances, and were justified in proceeding with the hear-

ings. Even if Zinsmeyer was placed in a difficult position with the late receipt of discovery from respondents, only a few hearings occurred in March, and Zinsmeyer still had considerable time throughout the rest of 1995 to prepare its case between the numerous and staggered hearing sessions. Thus, the Court declines to vacate the arbitration award based upon the arbitrators' failure to grant another continuance to Zinsmeyer.

B. Bias, Partiality and Misconduct of Arbitrators

Zinsmeyer asserts that it is evident from the record that the arbitrators were partial and biased against Zinsmeyer. Section 10(a)(2) allows a court to vacate an arbitration award "[w]here there was evident partiality or corruption in the arbitrators, or either of them." 9 U.S.C. § 10(a)(2).

Zinsmeyer cites to *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145 (1968), a "leading case on evident partiality." *See Olson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 51 F.3d 157, 159 (1995). *Commonwealth* held that an arbitrator's failure to disclose a business relationship that the arbitrator had with a party to the arbitration amounted to evident partiality warranting vacating an arbitration award. *Commonwealth*, 393 U.S. at 147-50. The Supreme Court held that arbitrators must "disclose to the parties any dealings that might create an impression of possible bias." *Id.* at 159. Zinsmeyer does not assert that any arbitrator failed to disclose any relationship with the parties. Thus, analogy to *Commonwealth* is of limited use in this action.

Zinsmeyer asserts that arbitrator Catlett was predisposed against Zinsmeyer because Catlett was made aware that Zinsmeyer had made an inquiry about Catlett's qualifications. The record shows that NASD revealed to Catlett which party sought more information regarding her qualifications. Zinsmeyer asserts that revealing to the arbitrator which party questioned her qualifications was contrary to NASD normal procedures. The record also shows that Zinsmeyer was aware these facts at the time the inquiry was made, as Catlett

submitted a her response in her effort to satisfy "any concerns claimant may have." Nothing suggests that Zinsmeyer objected to, or was precluded from objecting to, Catlett's remaining on the arbitration panel, either prior to or at any time during the arbitration proceedings, despite Zinsmeyer's awareness of this breach of NASD "normal procedures," and this Court declines to now consider such an objection, raised for the first time, in a motion to vacate.

Zinsmeyer points to certain events during the hearings as evidence of bias, partiality, and corruption on the part of the arbitrators. As the party seeking to vacate, Zinsmeyer

has the burden of proving that a reasonable person would have to conclude that an arbitrator was partial to the other party to the arbitration. This reasonable person standard requires a showing of something more than the appearance of bias, but not the insurmountable standard of proof of actual bias . . . the alleged partiality be direct, definite, and capable of demonstration rather than remote, uncertain or speculative. Furthermore, the party asserting evident partiality must establish specific facts that indicate improper motives on the part of the arbitrator.

Consolidated Coal Co. v. Local 1643, United Mine Workers of Am., 48 F.3d 125, 129 (4th Cir. 1995) (citations and quotations omitted); *see also Kaplan v. First Options of Chicago, Inc.*, 19 F.3d 1503, 1523 n.30 (3rd Cir. 1994) (evident partiality requires proof of circumstances powerfully suggestive of bias).

Zinsmeyer points to the arbitrators' comments about how long the proceedings were taking, the limited amount of compensation the arbitrators did receive, the time away from their businesses that the arbitration proceedings were causing, and the need for Zinsmeyer to more quickly present its case. Zinsmeyer also points to the arbitrators' handling of witness Richard Engelhardt during the May 15 and 16 hearing sessions. Based upon this conduct, along with certain exclusion of evidence and

a disregard of the law, Zinsmeyer asserts that it is reasonable to conclude that improper motives directed the arbitrators' decisions.

First, the Court has carefully reviewed the incidents involving the testimony of Engelhardt, for which the arbitration hearings were relocated to New York to accommodate witnesses, including Engelhardt. Zinsmeyer characterizes Engelhardt as a neutral third-party witness. It seem apparent that Engelhardt, by his former position at PaineWebber, was an important witness for providing information as to Reik's trading transgressions, and PaineWebber's and Mitchell Hutchins's lack of supervision of Reik. The transcript clearly shows that arbitrator Cipolla "blew up" at Engelhardt, which was precipitated largely by Engelhardt's insistence that he be allowed to address the panel on Engelhardt's own terms instead of through answering questions. While Cipolla's conduct was unprofessional, he did take a recess and later apologize to all parties, and Engelhardt for his conduct. Thus, viewed in context, the events of May 15 and 16 are not sufficient in themselves to demonstrate partiality or bias on the part of Cipolla.

Of more concern to the Court are the comments of the arbitrators regarding the length of time the proceedings were taking, the arbitrators' concern for the time away from their businesses or professions, and the limited amount of compensation they were to receive. It is clear from the comments by the arbitrators on March 28 and 29, and other comments made throughout the proceedings, that the arbitrators were concerned about the time that the proceedings were taking, as they were initially under the belief that the proceedings would take only one week. In Cipolla's comments on March 29, he indicates that he was concerned about how slowly the proceedings were progressing, in part, because of the objections and disagreements by the PaineWebber attorneys regarding the appearance of certain witnesses. Cipolla encouraged the attorneys to try to work out their disagreements so that the hearings would progress more smoothly. Cipolla also indicated at that

time, and at other times throughout the proceedings, that the panel was interested in getting to the substantive evidence of the case, and were not as concerned about a full formal presentation or any cumulative evidence. Even during the pre-hearing sessions, Cipolla expressed his opinion that, as an arbitration, the proceedings should be handled as expeditiously as possible. Cipolla's view that the proceedings should be handled in this manner is also reinforced in his limiting the amount of time for witness testimony, and his decision not to permit testimony of other clients of Bill Reik, possibly out of concern that this could consume considerable time with collateral matters.

The implication from the arbitrators' comments that Zinsmeyer hopes to draw is that the arbitrators's decisions regarding witnesses, testimony, and issues regarding the merits of Zinsmeyer's claim were infected and influenced by the arbitrators' desire to end the proceedings and to return to their more gainful personal businesses and professions. Zinsmeyer's raising this implication is not without merit. However, the Court must consider this in light of the record as a whole.

Throughout the arbitration, the arbitrators tried to accommodate the parties and witnesses, while faced with constant objections from the attorneys. This accommodation included moving the hearings to New York for several sessions. The arbitrators held a total of 38 hearing sessions, each approximately four hours long. While the arbitrators did preclude Zinsmeyer from presenting several witnesses who were customers of Reik and allegedly had similar problems with Reik's trading actions, the arbitrators indicated that Zinsmeyer could present such evidence regarding these other customers by presenting documentary evidence through Reik's trading activities and their relation to stock manipulation. Some of the arbitrators comments could be construed as hints toward Zinsmeyer as to their concerns about what evidence and elements of Zinsmeyer's case that they thought were lacking, and indicated that they wanted to hear evidence on those issues. Nonetheless, the record clearly shows that the arbitrators were concerned from the beginning about completing the arbitration as quickly as possible.

The arbitrators' extraneous comments regarding their compensation may be inappropriate, and could be expected to undermine a claimant's confidence in the fairness of an arbitration proceeding. The comments could be expected to affect the presentation of a claimant's case, as counsel would be concerned about testing the patience of the arbitrators. The Court does not find conclusive evidence that the arbitrator's decisions were infected by their bias towards ending the proceedings as quickly as possible so that they could return to their private businesses and professions. The comments do raise an inference that the arbitrators' comments reflected their attitude in unduly limiting Zinsmeyer's proof. However, because the Court concludes that other grounds exist for vacating the arbitration award, the Court need not rest its decision on these grounds.

C. Refusal to Consider Relevant Evidence

Zinsmeyer complains that the arbitrators refused to allow Zinsmeyer to call as witnesses other clients of Reik who similarly claimed that Reik had ignored or refused to follow their instructions or had acted contrary to their instructions. Zinsmeyer asserts that such evidence went to support its claim that Reik was involved in a fraudulent scheme. Zinsmeyer similarly complains that the arbitrators refused to allow its expert witness, Kalinowski, to give any opinion related to Reik's activities with regard to other clients of Reik. Zinsmeyer finally complains that the arbitrators refused to permit Zinsmeyer to present any live witnesses from Kidder Peabody and Morgan Stanley.

In *Grahams Serv. Inc.*, 700 F.2d at 422-23, the Eighth Circuit held that under the FAA, a party seeking to vacate on the grounds of the arbitrators' refusal to consider evidence is required to show not only an error of law by the arbitrators in excluding the evidence, but also that the error is one "'which so affects the rights of a party that it may be said that he was deprived of a fair hearing.'" *Id.* at 422 (quoting *Newark Stereotypers' Union No. 18 v. Newark Morning Ledger Co.*, 397 F.2d 594, 599 (3rd Cir.), *cert. denied*, 393 U.S. 954 (1968)).

As to Zinsmeyer's arguments concerning Kidder Peabody and Morgan Stanley, Zinsmeyer presents no basis suggesting it was deprived of a fair hearing. In lieu of live testimony, the arbitrators clearly permitted the parties to take lengthy depositions of whom Zinsmeyer considered key witnesses at both brokerage houses. The depositions were taken and the arbitrators had the transcripts before them when considering the motions to dismiss of Kidder Peabody and Morgan Stanley. Although Zinsmeyer complains that they were precluded from using live witnesses, Zinsmeyer points to no facts which might support its claims against these two respondents. As to the excluded testimony of Zinsmeyer's expert, Kalinowski, Zinsmeyer has failed to show how this evidentiary decision denied Zinsmeyer a fair hearing, as the Court cannot fairly assess what Kalinowski's testimony would have been.

Zinsmeyer goes to great lengths to assert that the testimony of other clients of Bill Reik's should have been admitted under Rule 404(b) of the Federal Rules of Evidence. Even if such testimony should have been admitted under Rule 404(b), the Court cannot conclude that the arbitrators' refusal to consider this evidence, in itself, deprived Zinsmeyer of a fair hearing. While such evidence would have been relevant for showing intent on the part of Bill Reik, the arbitrators' in refusing the evidence, clearly stated that they would consider documentary evidence of the trading activity and practices of Reik in other clients' accounts. Thus, Zinsmeyer has not shown that it entitled to relief on this ground.

D. Manifest Disregard of the Law

Zinsmeyer argues that the arbitrators acted in manifest disregard for the law. The Eighth Circuit has never adopted manifest disregard for the law as a basis for vacating an arbitrator's award, although it has discussed the basis in dicta. *See Marshall v. Green Giant Co.*, 942 F.2d 539, 550 (8th Cir. 1991); *Card v. Stratton Oakmont, Inc.*, 933 F. Supp. 806, 810-11 (D. Minn. 1996). Assuming that manifest disregard for the law is a valid basis for vacating an arbitration

award, the Eighth Circuit has articulated a very high and difficult standard which the party seeking to vacate the award must show:

> Manifest disregard of the law exists when the arbitrator commits an error that was obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term disregard implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it. There must be some showing in the record, other than the result obtained, that the arbitrators knew the law and expressly disregarded it . . . even if we agree . . . that the arbitrator made an error of law, we still cannot say that the arbitrator disregarded the law.

Marshall, 942 F.2d at 550; *see also ARW Exploration Corp.*, 45 F.3d at 1463. This standard does not permit the district court to review the correctness of the law applied by the arbitrators. Rather, the party seeking to vacate must point to some evidence in the record that the arbitrators knew the law and intentionally disregarded it. Zinsmeyer complains about the arbitrators' "determination that Zinsmeyer could not demonstrate that its damages were caused by the injuries demonstrated." Zinsmeyer states that the issue of causation — the damages sustained by Zinsmeyer as a result of the alleged market manipulation — was the central concern for the arbitrators. The record shows that after Zinsmeyer's expert testified as to issue of causation, the arbitrators still had concerns as to causation and proximate cause and asked for written briefs on the legal aspects of causation. Zinsmeyer and respondents each filed legal memoranda on the issue of causation, with each party citing case law and other authority.

In moving to vacate the arbitration, Zinsmeyer expends considerable effort explaining how the arbitrators incorrectly applied the relevant law to the facts of Zinsmeyer's claim, arguing that the arbitrators incorrectly placed the upon Zinsmeyer the burden of

proving "loss causation," *see Arthur Young & Co. v. Reves*, 937 F.2d 1310, 1327-31 (8th Cir. 1991) (discussing transaction causation and loss causation in 10b-5 context), and thereby, demonstrated a manifest disregard of the law by the arbitrators. In response, the PaineWebber respondents assert that the arbitrators' decision does not articulate the basis of their decision, nor the law applied, in granting PaineWebber's motion to dismiss, and thus, in cannot be concluded that the arbitrators' decision rested on the issue of causation or that the arbitrators deliberately ignored the correct law regarding causation in a failure to disclose action.

Zinsmeyer's argument proposes the exact inquiry into the merits and results of the arbitrators' decision that *Marshall* instructs against. Other than pointing to the case law and decision of the arbitrators and asserting that they must have applied the law incorrectly, Zinsmeyer has not provided evidence in the record suggesting that the arbitrators knew the law and expressly disregarded it. Thus, Zinsmeyer's motion to vacate on the grounds of manifest disregard of the law will be denied.

E. Procurement of Award by PaineWebber through "Undue Means"

Section 10(a)(1) of the FAA permits vacating arbitration awards where an award "was procured by corruption, fraud, or undue means." 9 U.S.C. § 10(a)(1). The terms corruption, fraud, or undue means are not precisely defined terms. Case law, however, provides some guidance. In *American Postal Workers Union, AFL-CIO, v. United States Postal Serv.*, 52 F.3d 359, 362 (D.C. Cir. 1995), the District of Columbia Court of Appeals explained that "undue means must be limited to an action *by a party* that is equivalent in gravity to corruption or fraud, such as a physical threat to an arbitrator or other improper influence." The Court held that merely presenting objectionable or inappropriate evidence did not constitute "undue means." *Id.* In *A.G. Edwards & Sons, Inc. v. McCollough*, 967 F.2d 1401, 1403 (9th Cir. 1992), *cert. denied*,

506 U.S. 1050 (1993), the Ninth Circuit explained that "sloppy or overzealous lawyering" did not constitute "undue means." Rather, the Court construed "undue means" as behavior that is "not proper," "immoral if not illegal," or "improper or wrongful." *Id.* at 1403-04; *see also Shearson Hayden Stone, Inc. v. Liang*, 493 F. Supp. 104, 108 (N.D. Ill. 1980) ("undue means" includes bad faith conduct), *aff'd*, 653 F.2d 310 (7th Cir. 1981). The Ninth Circuit also added that a party seeking to vacate on the grounds of "undue means" must also show that the conduct constituting the fraud or undue means was not discoverable at the time of the arbitration hearing and that there must be some causal relation between the conduct and that party's obtaining the arbitration award. *A.G. Edwards & Sons, Inc.*, 967 F.2d at 1403-04.

In supplemental briefing permitted by this Court, Zinsmeyer added its "undue means" ground upon which to vacate the award. Zinsmeyer asserts that the PaineWebber respondents hid certain documents material to the issues of Reik's transgressions and PaineWebber's, Mitchell Hutchins's, and William Witter's knowledge of and failure to correct Reik's questionable practices. As indicated above, Zinsmeyer's counsel has been involved in litigation in federal court related to claims of other persons who were allegedly injured by the trading activities of Reik. Zinsmeyer asserts, in its supplemental briefing, that it learned, through these related actions, after the arbitration was completed, of the existence of additional documentary evidence material to Zinsmeyer's claims, which was not produced by the PaineWebber respondents, even though such documents were sought in Zinsmeyer's discovery requests. Zinsmeyer has attached to its supplemental briefs copies of documents not made available to it in the Zinsmeyer arbitration. These documents relate to the investigations of Richard Engelhardt and other supervisors at Mitchell Hutchins and PaineWebber into specific questionable activities of Bill and Trey Reik, to legal implications of some of Bill Reik's activities, and to discussions relating to corrective actions that PaineWebber apparently considered taking. One document also relates to a dispute between PaineWebber and William Witter and involved a discussion of problems surrounding Reik.

The PaineWebber respondents admit that many of these documents were not provided to Zinsmeyer. The PaineWebber respondents argue that Zinsmeyer cannot show "undue means." They assert that they asserted that these documents were privileged; that they properly asserted a privilege regarding these documents; and that Zinsmeyer never sought to compel production of these documents after PaineWebber asserted their privileged status. Regarding the PaineWebber respondents' assertions, the record reveals the following.

At a hearing via telephone before Cipolla on January 17, 1995, at which Cipolla heard arguments on discovery motions, including a motion by Zinsmeyer to compel discovery, Cipolla, after first stating that the he wanted the arbitration to proceed "as expeditiously as possible," stated,

> As to those documents which — in which a privilege has been asserted, either attorney-client or work product, I am inclined at this particular point to have, in this case, I guess, the Respondents, identify those documents . . . I would like to see what the log, for lack of a better term, indicates, and if necessary, I have an in camera inspection of those documents.
>
> . . . .
>
> As a result, I think that it's going to be my determination and the panel's determination, if those privileges are challenged, we are going to have to listen to it. So that's basically what it is.
>
> . . . .
>
> As to those privileged items, I would like to see a log of those and then later go through an in camera inspection and we will just have to go through the documents and make rulings as we go.

After stating this, Zinsmeyer's counsel then volunteered that he knew the documents upon which PaineWebber asserted privileges; that he would, in an effort to expedite matters, send a letter identifying those

documents; and that PaineWebber should then produce such documents for in camera inspection. Zinsmeyer's counsel and PaineWebber's counsel then reached an apparent agreement that there were 26 such documents. This number was based upon Zinsmeyer's counsel's knowledge of 26 documents that a federal court ordered produced in the *Bond* litigation.

On January 18, the panel memorialized in writing its decision at the January 17 hearing. The panel ordered, as to all documents for which a privilege was asserted, in camera production and a copy of the privilege log for all such documents. Thereafter, in a motion to compel, Zinsmeyer sought production for in camera review of "all documents for which [PaineWebber] claim[ed] a privilege," and not just the 26 (later determined to be 24) documents discussed by counsel on January 17. Zinsmeyer identified 46 other documents on the privilege log that it wanted produced in camera and further requested that "[i]f the PaineWebber respondents are claiming privilege as to any of the other documents listed on the privilege log . . . that those documents be produced immediately for *in camera* review." Zinsmeyer requested that all other documents be produced, if no privilege was being asserted in the log. In a letter dated January 26, PaineWebber's counsel responded to this motion, asserting that it was agreed at the January 17 agreement that only 26 documents needed to be submitted to the panel for in camera review. PaineWebber's counsel objected to producing any other documents for such review.

In a letter dated February 27, NASD informed the parties that Cipolla had apparently granted a motion for reconsideration by PaineWebber. The letter indicated that Cipolla ordered PaineWebber to produce "the forty or so documents and the privilege log relating to the *Bond v. PaineWebber* which it claims to be privileged for in camera inspection," and that the parties could submit briefs on the issue of whether the documents were privileged. PaineWebber then submitted 46 documents and the panel ruled on whether the documents were privileged. The

panel found 20 of the group of 24 documents privileged and apparently found most or all of the 46 documents to be privileged.

The record suggests that the panel never required PaineWebber to produce for in camera inspection all documents to which PaineWebber asserted a privilege. Zinsmeyer asserts, however, that with respect to some of the documents identified in its supplemental briefs which were not produced by PaineWebber, that PaineWebber "hid" these documents in its 347-page privilege log containing nearly 2,000 documents by providing vague or misleading descriptions of the documents. Specifically, Zinsmeyer points to a July 10, 1990 Memorandum from Mary Joan Hoene, general counsel at Mitchell Hutchins, to Don Spencer, an attorney at Mitchell Hutchins, regarding "Reik Compliance Issues." PaineWebber produced in camera a draft version of this memorandum, while Zinsmeyer later discovered in the *Bond* litigation that a longer, final version of this memorandum, which contained more information, existed. PaineWebber's privilege log, makes no distinction or indication that two versions of this memorandum existed.

As to this document, PaineWebber responds that it did not need to produce the final version; that, in any event, the arbitrators would have found the final version privileged because they found the draft version privileged; and that any additional information in the final version would not have changed the outcome of the litigation because the panel heard other evidence and testimony on these issues.

Zinsmeyer next points to some handwritten notes of Engelhardt, written during a meeting with Hoene, Spencer and Cavell. The notes are identified by PaineWebber with the stamp number 303394. PaineWebber's privilege log indicates that document number 303394 is a document authored by Hoene and Cavell, both attorneys, and not Engelhardt. Zinsmeyer asserts that this inaccuracy prevented it from seeking in camera production of the document. PaineWebber makes no response in its brief with regard to this inaccuracy.

Zinsmeyer next points to a note written by Robert Berson, PaineWebber's general counsel, regarding a February 13, 1991 telephone conversation he had with William Witter. The conversation concerned Reik, his trading activities, legal problems surrounding Reik, and Reik's departure from PaineWebber and move to William Witter. Zinsmeyer states that this document was never presented to the panel and Berson never testified at the arbitration, although Zinsmeyer asserts that if it had known of this document, it would have pursued testimony from Berson and William Witter. Neither party (and notably PaineWebber) asserts that this document was identified on the PaineWebber privilege log. PaineWebber's only response is that this memorandum had nothing to do with Zinsmeyer, that it would have presented no additional evidence not already known to Zinsmeyer or not presented to the panel at arbitration.

Zinsmeyer also points circumstances regarding a nearly illegible handwritten document of notes of William Cavell and a document apparently referenced in that handwritten document. The handwritten document was produced by PaineWebber. At the March 28 arbitration hearing session, Zinsmeyer's counsel asked Cavell numerous questions regarding this document, trying to determine what Cavell's notes meant. Cavell's notes included Roman numerals I through IV with specific notes after each numeral. Zinsmeyer's counsel then cross-referenced these notes with another document produced by PaineWebber, the latter being typewritten. The typewritten document contained headings with Roman numerals I and II, but did not contain a III or IV. Noting that the subject matter of the Roman numerals I and II on each documents matched, Zinsmeyer's counsel specifically asked Cavell and PaineWebber's counsel if a complete typewritten document with Roman numerals III and IV existed. In response, PaineWebber's attorneys stated:

> I will just say for the record what we've said many, many times in the course of discovery: That is the only document that exists in the files. You have asked many times for that document. We've verified for you many times that that is all that we have in the files.

> For the record, I will repeat what we've said many, many times in the past; you have everything that exists in our client's file.

Zinsmeyer has now produced a lengthy typewritten document that includes Roman numerals I through VII, which clearly appears to be a complete version of the type-written document containing only Roman numeral I and II. The full document is a lengthy interoffice memorandum which details information compiled by Cavell, Engelhardt, and Don Spencer in their investigation of Reik's trading of Neutrogena securities. In their response to Zinsmeyer's supplemental memorandum, PaineWebber does not contest that this document was not produced by them; it asserts only that the matters discussed in this document were not central or relevant to Zinsmeyer's case and would not have made a difference in the outcome of the arbitration.

The Court concludes that the PaineWebber respondents' conduct regarding these undisclosed documents constitute "undue means," warranting vacating the arbitration award. The record before the Court, including the PaineWebber respondents' responses to Zinsmeyer's supplemental memoranda and the unequivocal statements of counsel during the arbitration hearing, clearly shows that certain documents were hidden by PaineWebber and kept from Zinsmeyer's discovery during the arbitration. It is clear also that these documents surfaced, or became known to Zinsmeyer, only after the arbitration hearing was completed, and especially after certain key witnesses were questioned by Zinsmeyer at the arbitration. While the PaineWebber respondents' counsel were within their proper bounds by zealously representing their clients and contesting issues of privilege regarding many of the documents involved in the arbitration, the record provides ample basis upon which the Court can find that PaineWebber and its counsel overstepped those bounds and improperly withheld documents from discovery. The record evinces bad faith and misconduct in withholding such discovery. Indeed, PaineWebber does not even attempt to

explain why some of these documents were not available to Zinsmeyer's counsel prior to or during the arbitration.[2]

The PaineWebber respondents suggest that even if such documents were not produced, the arbitration award should still be confirmed. The PaineWebber respondents make the assertion that the arbitrators would have found such documents privileged in any event. The Court declines to speculate as to what the arbitrators might have decided had PaineWebber been forthright in producing a document to the arbitrators in the first instance.

PaineWebber also asserts that the withheld documents would not have changed the outcome of the arbitration. PaineWebber suggests in its response to Zinsmeyer's second supplemental memorandum, that the arbitrators would have reached the same decision, and at one point, in reference to certain information within a withheld document, states that "[t]he panel agreed with PaineWebber that this activity did not constitute proof of manipulation." The Court finds such arguments without merit. PaineWebber's assertion that the same outcome would have occurred is contrary to its earlier position, asserted in response to Zinsmeyer's argument that the arbitrator's decision was in manifest disregard of the evidence, that the arbitrators did not articulate the basis of their decision and that it could not be determined from the record as to why the arbitrators reached their decision. The Court is not required to reweigh the evidence in light of the withheld documents and evidence.

Rather, the Court need only conclude that there be some causal relation between the conduct and that party's obtaining the arbitration award. *A.G. Edwards & Sons, Inc.*, 967 F.2d at 1403-04. Clearly, the withheld documents were material and relevant to Zinsmeyer's

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[2] As to some documents presented in Zinsmeyer's supplemental briefs, PaineWebber pointed out that some were in fact produced to Zinsmeyer, produced in camera, or were not required to be produced in camera by the arbitrators. Others, however, as discussed above, do not fall into any of these categories.

claims of transgressions by Bill Reik and the PaineWebber respondents, and were a source of important information as to Reik's activities. As such, their absence undoubtedly impacted upon Zinsmeyer's ability to pursue its case and examine key witnesses; their absence could certainly have impacted the decision making process of the arbitrators. In light of this withheld evidence, the Court cannot grant the PaineWebber respondents' motion to confirm the arbitration award.

III. Motions to Confirm Arbitration

While the Court will grant Zinsmeyer's motion to vacate the arbitration award with respect to PaineWebber Group Inc., PaineWebber Incorporated, Mitchell Hutchins Asset Management Inc., William Reik, Jr., and William D. Witter, Inc., Zinsmeyer has presented no basis upon which to vacate the award as to Morgan Stanley and Kidder Peabody. The claims brought against Morgan Stanley and Kidder Peabody were distinct from the claims against the PaineWebber respondents, and Morgan Stanley and Kidder Peabody were not involved with, or referenced in any of the withheld documents.

If a party fails to meet its burden of proof by establishing a statutory ground for vacating an arbitrator's award exists, confirmation of the award by the court is mandatory. *Domino Group, Inc. v. Charlie Parker Memorial Foundation*, 985 F.2d 417, 419-20 (8th Cir. 1993). Thus, the Court will confirm the arbitration award as to Kidder Peabody and Morgan Stanley.

Accordingly,

IT IS HEREBY ORDERED that the application of plaintiff Zinsmeyer Trusts to vacate an arbitration award relating to Morgan Stanley & Co., and Kidder Peabody & Co., Inc. [document #1 in Case No. 4:95CV02528 ERW] is **DENIED**.

IT IS FURTHER ORDERED that the counterclaim of defendant Morgan Stanley for an order and judgment confirming an

arbitration award [document #10 in Case No. 4:95CV02528 ERW] is **GRANTED**.

IT IS FURTHER ORDERED that the counterclaim of defendant Kidder Peabody & Co. for an order and judgment confirming an arbitration award [document #12 in Case No. 4:95CV02528 ERW] is **GRANTED**.

IT IS FURTHER ORDERED that the motion of plaintiffs PaineWebber Group Inc., PaineWebber Incorporated, Mitchell Hutchins Asset Management Inc., William Reik, Jr. and William D. Witter, Inc., for judgment confirming and arbitration award [document #1 in Case No. 4:95MC00318 ERW] is **DENIED**.

IT IS FURTHER ORDERED that the cross-motion of defendant Zinsmeyer Trust Partnership to vacate the arbitration award as to PaineWebber Group Inc., PaineWebber Incorporated, Mitchell Hutchins Asset Management Inc., William Reik, Jr. and William D. Witter, Inc. [document #4 in Case No. 4:95MC00318 ERW] is **GRANTED**. **IT IS FURTHER ORDERED** that the motion of PaineWebber for leave to file a response to Zinsmeyer's supplemental memorandum in support of its motion to vacate [document #53 in Case No. 4:95CV02528 ERW] is **GRANTED**.

IT IS FURTHER ORDERED that the motion of Zinsmeyer Trust Partnership for a hearing on the motions to vacate an the arbitration award [document #63] is **DENIED**.

A separate judgment and order shall accompany this memorandum and order.

Dated this 15th Day of April, 1997.

/s/ E. Richard Webber
UNITED STATES
DISTRICT JUDGE

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

No. 4: 95CV02528 ERW

ZINSMEYER TRUSTS PARTNERSHIP, a Missouri General Partnership, by Andrew Roberts Zinsmeyer Trust dated July 27, 1964, Jeffrey Woods Zinsmeyer Trust dated July Trust B dated November 29, 1971, Andrew R. Zinsmeyer Revocable Trust date August 27, 1982, Mary Jane Zinsmeyer Trust dated August 27, 1964, Andrea Zinsmeyer Trust B dated April 15, 1983, Daniel M. Zinsmeyer Trust B dated February 5, 1985, Amy S. Zinsmeyer Trust dated January 19, 1987, Jonathan Roberts Zinsmeyer Trust B dated February 10, 1989, Daris Zinsmeyer Education Trust dated December 22, 1982, and Jada Partnership, General Partners,

Plaintiff/counter-claim defendant,

v.

MORGAN STANLEY & CO., INCORPORATED; KIDDER PEABODY & CO., INCORPORATED,

Defendants/counter-claimants.

Consolidated with:
No. 4: 95MC00318 ERW

PAINEWEBBER GROUP INC.; PAINEWEBBER, INC.; MITCHELL HUTCHINS ASSET MANAGEMENT INC.; WILLIAM J. REIK, JR.; WILLIAM D. WITTER, INC.;

Plaintiffs,

v.

ZINSMEYER TRUSTS PARTNERSHIP,

Defendant.

[Filed April 15, 1997]

JUDGMENT AND ORDER

IT IS HEREBY ORDERED, ADJUDGED and DECREED that the arbitration award reflected in the November 30, 1995 Final Order of the National Association of Securities Dealers, Inc., regarding the claims of Zinsmeyer Trusts Partnership against PaineWebber, Inc., PaineWebber Group, Inc., Mitchell Hutchins Asset Management Inc., William J. Reik, Jr., William D. Witter, Inc., Morgan Stanley & Co., Inc., and Kidder Peabody & Co., Inc., is **CONFIRMED** as to the NASD award in favor of Morgan Stanley & Co., Inc., and Kidder Peabody & Co., Inc., and against Zinsmeyer Trusts Partnership.

IT IS FURTHER ORDERED that the arbitration award reflected in the November 30, 1995 Final Order of the National Association of Securities Dealers, Inc., regarding the claims of Zinsmeyer Trusts Partnership against PaineWebber, Inc., PaineWebber Group, Inc., Mitchell Hutchins Asset Management Inc., William J. Reik, Jr., William D. Witter, Inc., Morgan Stanley & Co., Inc. and Kidder Peabody & Co., Inc., is **VACATED** as to the NASD award in favor of PaineWebber, Inc., PaineWebber Group, Inc., Mitchell Hutchins Asset Management Inc., William J. Reik, Jr., and William D. Witter, Inc. and against Zinsmeyer Trusts Partnership.

Dated this 15th Day of April, 1997.

/s/ E. Richard Webber
UNITED STATES
DISTRICT JUDGE

APPENDIX C

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

Case No. 4:95CV02528 ERW

ZINSMEYER TRUSTS PARTNERSHIP,
Plaintiff,

v.

MORGAN STANLEY & CO. INC. and, (sic)
Defendants.

MEMORANDUM AND ORDER

[Filed: Jan. 29, 1998]

This matter is before the Court on plaintiff William D. Witter, Inc.'s ("Witter") motion to alter or amend judgment vacating arbitration award and to enter judgment confirming arbitration award [document #69], and defendants PaineWebber Group Inc., PaineWebber Incorporated, Mitchell Hutchins Asset Management Inc., and William J. Reik's motion to alter or amend judgment [document #70].

On April 15, 1997, the Court entered a Memorandum and Order denying the motion of plaintiffs PaineWebber Group Inc., PaineWebber Incorporated, Mitchell Hutchins Asset Management Inc., William Reik, Jr. and William D. Witter, Inc., for judgment confirming an arbitration award, and granting the cross-motion of defendant Zinsmeyer Trust Partnership to vacate the arbitration award as to PaineWebber Group Inc., PaineWebber Incorporated, Mitchell Hutchins Asset Management Inc., William Reik, Jr. and William D. Witter, Inc. Plaintiffs Witter, the PaineWebber defendants ("PaineWebber"), and Reik now move to alter or amend this judgment.

Motions for reconsideration, under Rule 59(e), are intended to correct manifest errors of law or fact or to present newly discovered evidence. *Hagerman v. Yukon Energy Corp.*, 839 F.2d 407, 414 (8th Cir.), *cert. denied*, 488 U.S. 820 (1988). Rule 59(e) motions should not be used to "rehash arguments previously considered and rejected by the court." *Schweitzer-Reschke v. Avnet, Inc.*, 881 F. Supp. 530, 532 (D. Kan. 1995); *see also Lewis v. United States*, 555 F.2d 1360, 1362 (8th Cir. 1977).

Witter asserts that granting the motion is necessary to correct manifest errors of law and fact, and to prevent manifest injustice. Witter relies on the fact that it is a separate party from PaineWebber, and is independently represented. Furthermore, Witter contends that neither Zinsmeyer nor the Court has identified any conduct by Witter which would support a finding that Witter procured the arbitration award through undue means, and that there is no basis to charge Witter with the alleged conduct of PaineWebber.

Zinsmeyer responds that Witter cannot demonstrate a basis for altering or amending the judgment because fundamental fairness dictates that it cannot benefit from PaineWebber's undue means, and also because an additional basis other than undue means existed under the Court's Memorandum and Order to deny Witter's motion.

PaineWebber and Reik submit that the evidence before the Court does not support a finding of intentional misconduct. They contend that there were only two isolated errors in a privilege log that contains some two thousand entries. Furthermore, they assert that the record reflects that the privilege log and related materials were sufficient to enable Zinsmeyer's counsel to challenge PaineWebber's privilege assertions. PaineWebber and Reik contend that the panel's failure to review the four documents had nothing to do with any alleged misconduct by PaineWebber's counsel, and that there is no evidence that the errors were intentional.

Zinsmeyer responds that PaineWebber and Reik have not demonstrated any of the recognized bases under which they are entitled

to have the judgment altered or amended. However, in the alternative, Zinsmeyer argues that they could not have discovered PaineWebber's undue means because those means did not become discoverable until after arbitration. Furthermore, Zinsmeyer notes that the documents that were withheld contained evidence that would have been critical in the arbitration.

PaineWebber's mischaracterization of its behavior, which requires reversal of the arbitration award, by describing its conduct that invalidated hundreds of hours of hearings, as unintentional and incidental is in direct conflict with the record and the Courts' conclusions. The arbitration award which the Court must reverse was procured through undue means perpetrated by PaineWebber. Witter, like all participants in the arbitration process, will suffer from PaineWebber's conduct. At the same time the integrity of the judicial process will not permit Witter to benefit from these actions of PaineWebber. Thus, the Court finds that there are no manifest errors of law and fact, and that granting Witter's motion is not necessary to prevent manifest injustice. Therefore, Witter's motion to alter or amend will be denied.

The Court agrees with Zinsmeyer that PaineWebber and Reik have not demonstrated any grounds under which they are entitled to have the judgment altered or amended. Specifically, the Court finds that their arguments are simply an attempt to "rehash arguments previously considered and rejected by the court," and misrepresent the nature of their conduct which requires the Court's action in reversing the arbitration award. *See Schweitzer-Reschke*, 881 F. Supp. at 532. Therefore, PaineWebber and Reik's motion to alter or amend will be denied.

Accordingly,

IT IS HEREBY ORDERED that plaintiff William D. Witter, Inc.'s ("Witter") motion to alter or amend judgment vacating arbitration award and to enter judgment confirming arbitration award [document #69] is **DENIED**.

IT IS FURTHER ORDERED that defendants PaineWebber Group Inc., PaineWebber Incorporated, Mitchell Hutchins Asset Management Inc., and William J. Reik's motion to alter or amend judgment [document #70] is **DENIED**.

Dated this 29th day of January, 1998.

/s/ E. Richard Webber
E. RICHARD WEBBER
UNITED STATES
DISTRICT JUDGE

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 98-1649/1741EMSL

PaineWebber Group, Inc.; PaineWebber, Inc.;
Mitchell Hutchins Asset Management, Inc.;
William J. Reik, Jr.; William D. Witter, Inc.,
Appellants,

vs.

Zinsmeyer Trusts Partnership,
Appellee.

Order Denying Petition for Rehearing
and for Rehearing En Banc

The petition for rehearing en banc is denied. Judge McMillian would grant the petition.

The petition for rehearing by the panel is also denied. (5128-010199)

October 19, 1999

Order Entered at the Direction of the Court:
/s/ Michael E. Gans
Clerk, U.S. Court of Appeals, Eighth Circuit

NGNA
Rock style - investment type of account
Background piece on NGNA

[illegible] accounting
[illegible] client
clients
CWSR

copying
history
price
work billing

III Concerns in NGNA

1. Concentrated position
2. Held order - order memorandum - allocations prepared later
3. 3(c)(7) Act
4. Investment Supplier
5. Access Cypress fund inquiry

6. 5/00 NASD market timing NGNA 3/1/00-01/17/00

IV Conclusion

Select positions, familiarity with [illegible]

[illegible] further review:
- investment
- market dominated
- insider ownership

26.8 -

PLAINTIFF'S EXHIBIT 447

EXHIBIT 5

02021

BEST AVAILABLE COPY

APPENDIX F

EXHIBIT 6

PLAINTIFF'S EXHIBIT 179

I. Reik Investment Style

Bill Reik has been with Mitchell Hutchins since 1974. His primary investment style is to research, follow and invest in companies meeting four investment criteria:

a) a strong market niche or franchise;

b) a significant family, director or officer ownership;

c) little or no long term debt;

d) little or no institutional ownership or research following.

Reik clients are primarily invested in 12 companies meeting the above criteria. Attached is a summary page reflecting these companies. Positions in four of the twelve exceed 5% and Mitchell Hutchins files Schedule Gs for such positions. The investment strategy is long term holding of these positions.

Bill Reik has developed relationships with most of companies' managements through the long term and large holdings in these companies. He also has working relationships with the market-makers or select broker-dealers through which he handles client orders. Reik's trading technique for exchange listed issues is for trades to go through the Mitchell Hutchins trading desk. Trades in over-the-counter issues are handled directly by Trey Reik (son) with market-makers and then processed through the trading desk.

His client base includes the following types of clients:

a) discretionary accounts handled on a fee basis pursuant to an advisory agreement;

b) non-discretionary accounts handled on a fee basis pursuant to an advisory agreement;

c) Cypress Fund - PaineWebber's closed-end fund based on the Reik investment style with about $65 million in assets;

d) brokerage accounts based on commissions only.

The advisory clients include individuals, trusts, pension plans, and institutions including foundations and municipalities with $400.5 million in assets under management.

MITCHELL HUTCHINS — CLIENT & FUND HOLDINGS — April 1990

Company	Shares Out-standing	MHAM % of O/S	Family Officer or Director Holdings	No. of Reg. Share-holders	Price 3/30/90	P/E	(1989) Average Daily Volume	12/01/89 MHII
Frisch's Rest.	5.4	42.3	45%	2400	21 1/2	48	3,200	0
Tejon Ranch	12.6	15.9	50%*	928	46 5/8	220	4,500	0
Neutrogena	26.8	16.8	52%	1192	22	18	56,300	0
Medicine Shoppe Intl.	8.1	9.8	35%	472	22***	26	26,000	0
Williams Sonoma	6.1	5.3	40%	337	30 3/4	22	12,700	0
Church & Dwight	20.7	4.5	50%	5000	16 3/8	33	59,800	0
Smucker & Co.	7.4	4.4	27%	4115	64 3/4	16	7,500	0
American Precision	5.8	3.8	21%	981	20	27	2,900	0
Star Banc Corp.	28.7	2.3	0	7253	19 1/4	10	16,300	0
Tootsie Roll Ind.	9.3	1.3	50%	7970	35 5/8	17	7,500	0
McCormick & Co., Inc.**								
Voting	3.4		100%	1456	22***	17	135,800	0
Non-voting	17.7	1.69		6713				
Tiffany & Co.	15.2	.57	25%	1281	45	(illegible)	81,200	0

* Times Mirror & affiliates

** All voting shares 100% controlled by management & family

*** Stock splits -

Medicine Shoppe 3 for 2 - 12/4/89

McCormick 2 for 1 - 1/19/90

0120L/7

HOLDINGS BY PORTFOLIO MANAGER—
MUTUAL FUNDS
(In thousands of shares)

April 1990

	Reik Clients	Cypress Fund	Other Managers
Firsch's Rest.	1,480	803	Not Meaningful
Tejon Ranch	1,920	79	—
Neutrogena	3,815	699	—
Medicine Shoppe, Intl.	628	169	—
Williams Sonoma	203	118	—
Church & Dwight	880	55	—
Smucker	277	51	—
American Precision	54	165	—
Star Banc	482	165	—
Tootsie Roll	66	51	—
McCormick & Co.	146	152	—
Tiffany & Co.	11	75	—

0120L/8

II. Neutrogena Corp. Background

Neutrogena Corporation (NGNA) is a Los Angeles, CA based company that offers a line of premium quality specialty skin and hair care products. It is traded on NASDAQ and has 26.8 million shares outstanding.

Bill Reik has been accumulating NGNA shares for his advisory clients for about 10 years and in Cypress Fund since 1986. A breakdown of current Reik clients holdings is as follows:

Outstanding shares	26.8 million	100%
Family Ownership	13.7 million	51%
NGNA Float	13.1 million	49%

MHAM Accounts	Shares	% Outstanding	% Float
Total Reik client holdings	4.7 million	17.6%	36%
Reik Discretionary including Cypress (733,800)	2.1 million	7.8%	16%
Reik non-discretionary	2.4 million	8.9%	18%
Reik Brokerage accounts including W. Reik personal holding of 33,218 shares	.2 million	.7%	1.5%
Account 300P	.6 million	.2%	.4%

The average client cost basis is about $10, although the Fund's average cost (low $20's) is higher than the client cost. Mitchell Hutchins has filed Schedule Gs for NGNA and at 12/31/89,

our reported holding (discretionary) was 7.69% (2,005,459 shares).

NGNA has came under price pressure in the last several months with a rising short interest (currently about 1 million shares) due to several factors. The company historically has had very strong earnings growth which has now slowed due to increased competition from major consumer products companies, market saturation, a need for international expansion and research capital, research analysts' negative opinions, company resignations, and reduced company expectations.

The NGNA price history has ranged from approximately $2 in 1982 to $35 in 1989 with six stock splits/stock dividends since 1984. It is currently trading at $21+ having dipped recently to the $18 - $19 range. Average daily volume in 1989 was about 56,000 shares. There are twenty market-makers listed for NGNA.

APPENDIX G

EXHIBIT 3

—CONFIDENTIAL—
ATTORNEY-CLIENT PRIVILEGED

Interoffice **PaineWebber**

TO: ROBERT M. BERSON, ESQ.

FROM: MARK COMMANDER
MARY JOAN HOENE, ESQ.

DATE: JUNE 11, 1990

SUBJECT: WILLIAM J. REIK, JR.

Pursuant to your request, following is a review of the activity in the securities of Neutrogena Corp. Much of the information contained herein has been compiled by Bill Cavell, Rick Engelhardt and Don Spencer.

I. REIK INVESTMENT STYLE

Bill Reik has been with Mitchell Hutchins ("MH") since 1974. His primary investment style is to research, follow and invest in companies meeting four investment criteria:

1.) a strong market niche or franchise;

2.) a significant family, director or officer ownership;

3.) little or no long term debt;

4.) little or no institutional ownership or research following.

Reik clients are primarily invested in 12 companies meeting the above criteria. Attached is a summary page reflecting these holdings (see Exhibit A). Positions in four of the twelve exceed 5% of the outstanding shares and MH files

Schedule 13Gs for such positions. The investment strategy is long term holding of these positions.

Bill Reik has developed relationships with most of companies' managements through the long term and large holdings in these companies. He also has working relationships with the market-makers or select broker-dealers through which he handles client orders. Reik's trading technique for exchange listed issues is for trades to go through the MH trading desk. Trades in over-the-counter issues are usually handled directly by Trey Reik (Bill's son) with market-makers and then processed through the trading desk. This manner of effecting and recording OTC transactions is directly related to the concerns which arise in connection with the trades of April 18 and 19, 1990.

Reik has the following types of clients:

a.) discretionary accounts handled on a fee basis pursuant to an advisory agreement;

b.) non-discretionary accounts handled on a fee basis pursuant to an advisory agreement;

c.) Cypress Fund - PaineWebber's closed-end fund based on the Reik investment style with about $65 million in assets; and

d.) brokerage accounts based on commissions only.

The advisory clients (a, b, and c above) consist of individuals, trusts, pension plans, and institutions including foundations and municipalities, with a total of $400.5 million in assets under management.

II. NEUTROGENA CORP. BACKGROUND

Neutrogena Corporation (NGNA) is a Los Angeles, CA based company that offers a line of premium quality spe-

cialty skin and hair care products. It is traded on NASDAQ and has 26.8 million shares outstanding.

Bill Reik has been accumulating NGNA shares for his clients for about 10 years and in Cypress Fund since 1986. There are 26.8 million shares outstanding of NGNA. Family ownership represents 13.7 million shares (51%) with a public float of 13.1 million shares (49%). Reik accounts, including Cypress Fund, account for a significant portion of the public shares.

A breakdown of current Reik clients' holdings is as follows:

MHAM Accounts	Shares	% Outstanding	% Float
Reik Discretionary including Cypress (733,800)	2.1 million	7.8%	16%
Reik non-discretionary	2.4 million	8.9%	18%
Reik Brokerage accounts including W. Reik personal holding of 33,218 shares	.2 million	.7%	1.5%
Account 300P	.6 million	.2%	.4%
Total Reik client holdings	4.7 million	17.6%	36%

The average client cost basis is about $10, although the Fund's average cost (low $20's) is higher than the client cost. MH has filed Schedule 13Gs for NGNA and at 12/31/89, our reported holding (discretionary) was 7.69% (2,005,459 shares).

NGNA has came under price pressure in the last several months with a rising short interest (currently about 1 million shares) due to several factors. The company historically has had very strong earnings growth which has now slowed due

to increased competition from major consumer products companies, market saturation, a need for international expansion and research capital, research analysts' negative opinions, company resignations, and reduced company expectations.

The NGNA price history has ranged from approximately $2 in 1982 to $35 in 1989 with six stock splits/stock dividends since 1984. It is currently trading at $20 having dipped recently to the $18 - $19 range. Average daily volume in 1989 was about 56,000 shares. There are approximately twenty market-makers listed for NGNA. Reik executes most of his transactions with Jesup and Lamont, one of these twenty dealers; the reasons he offers for doing do are discussed in Exhibit B. He also uses Kidder and Shearson on occasion.

III. ACTIVITY OF APRIL 18 AND 19, 1990

Reik accounts purchased a total of 124,000 shares of Neutrogena on the two days in question. Order tickets relating to each of these trades were not processed until the day before settlement. As noted earlier, Reik does not transact OTC business through the MH trading desk but rather places orders directly with market makers. Aside from the Reiks (or their assistants), no one else at MH is aware of the existence of a pending or consummated transaction handled in this manner until an order ticket is furnished to the MH trading desk. Inasmuch as Reik does not possess a time stamp, his order memoranda bear no record of time of entry or execution. In short, it is not possible to ascertain when OTC orders placed by Reik directly with a market maker are entered or executed. The time stamp subsequently placed on such order tickets by the MH trading desk has no regulatory relevance.

Significant questions arise from business conducted in this manner. In addition to concerns relating to the applicable

regulations governing the creation and maintenance of books and records, the methodology described above affords the opportunity of "warehousing" positions. The ability to absorb selling pressure is also enhanced when additional time to locate purchasers is thus made available. Questions as to motive must be raised when the allocation of a large block purchase is delayed, particularly when the purchaser already owns a substantial position and the security has been subject to recent selling pressure.

IV. THE "300P" ACCOUNT

Bill Cavell and Don Spencer met with Bill Reik, Trey Reik and Breda Beckerle on June 5, 1990 to discuss the Neutrogena purchases by the 300P account. Reik first gave historical background on the business and results of Neutrogena and the rationale for his large investment on behalf of his clients and the Fund. He described several recent developments and trends which could adversely impact Neutrogena for the short term, and expressed concern over the high level of short activity in Neutrogena's stock.

Reik explained that, strategically speaking, Neutrogena has long been a prime candidate for a merger with a large consumer products company but that the founding family, who together own 51% of Neutrogena, have always been reluctant to sell. He said he had approached Lloyd Cotsen, Neutrogena's chairman, and suggested that it would benefit Neutrogena if a number of large consumer products companies took substantial positions in Neutrogena, since those companies would understand Neutrogena's business from the long-term point of view and would not over-react to short-term developments. Cotsen did not object to this idea.

Reik then, through Rho Management (which has an advisory relationship with Colgate Palmolive), received an order from Colgate for up to $5 million worth of Neutrogena,

and this order was later increased as it was filled to just under $15 million worth (the Hart-Scott threshold). (The account was opened in the name "300P" to protect the identity of the purchaser.) Reik states that he learned from either Rho Management or Colgate that Martin Lipton is advising Colgate in some capacity and that Lipton expressed concern that Colgate establish a record to show that it is not acting in concert with Reik or any Reik affiliate. Reik's contact at Rho Management is Jack Hyland, a former PaineWebber investment banker. It is not know whether Rho approached Reik or Reik approached Rho.

Reik said that he would like to get other consumer products companies to make substantial investments in Neutrogena. He indicated that he is seeking to contact a number of companies, including Procter and Gamble, Johnson & Johnson, L'Oreal and a Japanese company. He further advised that he was working with Herc Segalas to help get at least some of these companies involved, and had contacted other investment bankers and other intermediaries who might help him with other companies. As discussed earlier, the Schedule 13Gs which have been filed include only Reik's discretionary accounts' holdings. No intent other than investment (in the ordinary course of business) has been reflected on these filings.

Reik was cautioned about the need to limit direct contact with these potential investors to avoid the possibility that he might be deemed to have received inside information, be deemed to be acting in concert with some other investor or expose himself and the firm to burdensome litigation and regulatory scrutiny. The possibility was also raised that these activities could result in his being restricted from trading his clients' or the Fund's Neutrogena stock. It was suggested that, if other companies decide to take a Neutrogena position, the brokerage business should be declined. Reik told us that turning away the brokerage business was problematic for the following reasons:

(1) The commissions could be substantial.

(2) He has the best knowledge and experience in the market for Neutrogena, and the prospective investors might not want to deal with someone else.[1]

(3) If another broker attempted to make large Neutrogena purchases, it might cause speculation and a price run-up. The market is accustomed to seeing Reik make large Neutrogena purchases.

Reik's selection of Jesup & Lamont as dealer for the bulk of the Neutrogena orders, and the execution of some trades at a $1/16 interval, was also discussed. As mentioned earlier, these matters are addressed in Exhibit B.

V. REGULATORY SCRUTINY OF REIK ACTIVITIES

On at least three occasions one of the SRO's has made inquiry in relation to Reik activities. Each inquiry concerned one of the "concentrated" positions shown in Exhibit A.

The American Stock Exchange is currently reviewing certain activity in the common stock of Frisch's Restaurants. The review was instigated by the simultaneous movement (in late 1987) of Frisch's shares from margin to cash accounts by a number of Reik's customers, resulting in PaineWebber's need to call in outstanding stock loans during January 1988. (A significant short position in Frisch's existed at the time.) PaineWebber later received a report prepared by the law firm of Rosenman & Colin, apparently at the behest of a client (Gilder Gagnon) maintaining a substantial short position in Frisch's. This report, dated July 22, 1988 and entitled "Report on Trading Activity in the

[1] Given that Colgate is willing to use Reik as agent rather than deal directly with a market-maker, presumably Colgate sees important advantages to dealing with Reik.

Stock of Frisch's Restaurants, Inc.", alleges among other things that Reik was "marking the close", splitting orders to create the appearance of multiple executions and otherwise executing orders in a fashion designed to manipulate the price of the stock. (Notwithstanding such allegations, it appears that certain similar activities may exist in Neutrogena transactions.) The AMEX investigation is currently being handled for PaineWebber by Roberta Carmel of Kelly Drye & Warren.

REDACTED

The AMEX is also conducting a review of transactions in Cypress Fund. The review is apparently focussing on certain specific transactions executed at or near the close of trading on several days. (It should be noted that in accordance with usual MH practice for exchange-listed securities, Reik phoned these orders to the MH trading desk without providing any account designations.) It appears that a number of transactions for accounts handled by Reik, as well as certain transactions for an account serviced by our Encino, CA office — Sandra Kiratsoulis and Richard Kiratsoulis, JTWROS — were executed at or near the close. The Encino account also owns substantial positions in a number of other "Reik" stocks. The nature of any relationship between Reik and the Kiratsoulis' is unclear at this time.

In November 1989, counsel to NAV Partners sent a letter to the SEC alleging that Reik or his affiliated accounts had entered transactions in Cypress shares intended to mark the close, citing specific trades on several trading days. Mitchell Hutchins Legal and Kirkpatrick & Lockhart reviewed all Mitchell Hutchins trading tickets for the days in question, and found that, with one exception, the trades cited were not those of Reik or his client's. Kirkpatrick & Lockhart accordingly told the SEC that the allegations were unfounded.

Finally, the NASD has just commenced a review of trading activity in the common stock of Neutrogena for the period March 1 through April 17, 1990. Standard trading information has been requested.

VI. INVESTMENT BANKING ACTIVITIES

Hercules Segales of the IBD has discussed the potential acquisition of Neutrogena with a number of possible suitors. Segales indicates that at least preliminary general conversations have been held recently with both L'Oreal and Johnson & Johnson, although it appears that L'Oreal may be uninterested at this time. Reik seems to have had a number of conversations with Segalas on this topic and has suggested several potential suitors for Segalas' consideration. A copy of a letter dated May 14, 1990, from Segalas to a director of L'Oreal, is attached as Exhibit C. Among other things, a potential investment banking fee is discussed therein.

VII. CONCLUSION

Based upon the foregoing, and in consideration of the potential for market domination, it appears appropriate to effect the following steps:

1. Create a Chinese Wall between Reik and a) the rest of MH, b) PaineWebber's IB Division and c) PaineWebber's Equity Division.

2. Add Neutrogena to the Firm's Watch List.

3. Prohibit, pending a full review of the situation, any additional purchase transactions in Neutrogena by Cypress Fund, *all* other accounts handled by Reik and the accounts of Reik and related persons. Sales transactions would not be restricted — though subject to approval by MH Legal — unless such sales are inci-

dent to the accumulation of a substantial position or other activity of a banking nature.

4. Prohibit Reik from soliciting transactions in Neutrogena of a brokerage or banking nature, directly or indirectly (except as set forth in 3, above), within PaineWebber, Mitchell Hutchins or otherwise.

5. Commence a review of the overall nature and attendant risks of Reik's investment style, especially as related to the trading practices employed in the securities of issuers where a substantial position is owned.

6. Require that Reik place and execute all orders through the MH trading desk, as is the usual practice for other MH portfolio managers.

7. Implement all recommendations which arise from the previously requested and scheduled review by Management Audit of the existing system of supervision and control over MH and Reik in particular.

ca

APPENDIX H

Hearing Transcript 3/28/95, Vol. II

* * *

[238]

Re: Zinsmeyer Trusts Partnership, etc.
vs.
PaineWebber Group, Inc., etc.

March, 28, 1995

ARBITRATION HEARING, VOLUME II

* * *

[423]

MR. DOUGLASS: Ken, this is the form document for 179 that was produced to us; all right? If you have a complete copy of the memo and it exists, we would appreciate it being produced.

MR. LYONS: I will just say for the record what we've said many, many times in the course of discovery: That is the only document that exists in the files. You have asked many times for that document. We've verified for you many times that that is all that we have in the files.

MR. DOUGLASS: All right, but in light of Mr. Cavell's testimony, and in light of this memo, I'm asking if there is a III and IV; okay?

MR. HIGGINS: Mr. Cavell didn't tell you **[424]** there was a III and IV.

MR. DOUGLASS: I understand that. If there is one, I'd like to see it.

MR. LYONS: For the record, I will repeat that we've said many, many times in the past; you have everything that exists in our client's file.

* * *

APPENDIX I

EXHIBIT 2

Interoffice **PaineWebber**

MEMORANDUM

TO: File

FROM: Robert M. Berson, Esq.

Re: *Bill Reik*

DATE: February 13, 1991

At about 4:00 p.m., I returned a telephone call from Bill Witter who telephoned me earlier in the afternoon. Mr. Witter said he was calling on behalf of Bill Reik who was now working at his company. He said that it was not professional or appropriate for PaineWebber to hold Reik's personal account hostage. I told Witter that he was treading on thin ice; that he is a Director of the Cypress Fund; that Reik has exposed the Directors personally to potential problems; that he does not have all the facts; that the customer situations involved millions of dollars of potential losses and that there is reason to believe Reik was primarily responsible for same and that I had told Reik on February 8th to obtain counsel for the purpose of representing him in negotiating with us an amicable resolution of the customer problems, his participation therein and outstanding compensation issues.

Witter reiterated that although he was not a lawyer he felt that PaineWebber was not treating a Managing Director fairly. He said that Reik made PaineWebber much money and this was no way to show it. I told Witter that it was indeed awkward for him to be advocating relief for Reik under any circumstances; that I knew him indirectly through Haig Casparian; that perhaps he ought to chat with Haig before he involved himself any further on Reik's behalf; and that he was placing himself, in my view, in a potential conflict situation if he pursued this further on Reik's behalf.

Witter went on to `1that he would like to work this out in a professional manner. I said that is was in everyone's interest that this matter be resolved privately between Reik and PaineWebber because it would not be in anyone's interest to air these matters publicly. I urged him to have Reik obtain a lawyer. I said that Reik has shown a disdain for spending one dime on anything, including a financial participation in the Beattie Motors case and that he would not spend his money to retain counsel.

I told Witter that Reik has access to his personal account. He can enter orders but cannot withdraw funds until we had the opportunity to study the account. Witter requested that he be given a copy of Reik's margin account because Reik wanted to remove cash. I said I would discuss this with Reik personally and that I would not discuss this with him, only with Reik or his lawyer. I told him I would prefer a lawyer. He said he hoped we could work this out.

RMB:SP

2635L